Southern Union Company
Department of Telecommunications and Energy
D.T.E. 04-75
Record Request: **DTE-2**
August 23, 2004
Person Responsible: David J. Kvapil

Record Request DTE-2 (Tr. 1, at 39-40)

Please provide the most recent Form 10-Q for Southern Union Company.

Response

Please see Attachment RR-DTE-2. As noted during evidentiary hearings, the Company's Form 10-K is not yet completed, but is scheduled to be filed with the SEC by September 15, 2004. The Company will provide a copy of the Form 10-K to the Department as soon as it is available.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

For the quarterly period ended

March 31, 2004

Commission File No. 1-6407

SOUTHERN UNION COMPANY

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**75-0571592** (I.R.S. Employer Identification No.)
One PEI Center, Second Floor **Wilkes-Barre, Pennsylvania** (Address of principal executive offices)	**18711** (Zip Code)

Registrant's telephone number, including area code: **(570) 820-2400**

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange in which registered
Common Stock, par value $1 per share	**New York Stock Exchange**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ✓ No __

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).
Yes ✓ No __

The number of shares of the registrant's Common Stock outstanding on May 7, 2004 was 73,221,049.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
FORM 10-Q
March 31, 2004
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SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
	(thousands of dollars, except shares and per share amounts)	
Operating revenues	$ 774,579	$ 535,663
Cost of gas and other energy	(454,736)	(356,393)
Revenue-related taxes	(21,951)	(17,870)
Operating margin	297,892	161,400
Operating expenses:		
Operating, maintenance and general	106,809	48,203
Depreciation and amortization	26,419	14,621
Taxes, other than on income and revenues	14,299	6,434
Total operating expenses	147,527	69,258
Net operating revenues	150,365	92,142
Other income (expense):		
Interest	(31,055)	(19,840)
Dividends on preferred securities of subsidiary trust	--	(2,370)
Other, net	1,451	5,223
Total other expenses, net	(29,604)	(16,987)
Earnings from continuing operations before income taxes	120,761	75,155
Federal and state income taxes	45,394	28,921
Net earnings from continuing operations	75,367	46,234
Discontinued operations:		
Earnings from discontinued operations before income taxes	--	62,992
Federal and state income taxes	--	45,327
Net earnings from discontinued operations	--	17,665
Net earnings	75,367	63,899
Preferred stock dividends	(4,341)	--
Net earnings available for common shareholders	$ 71,026	$ 63,899
Net earnings available for common shareholders from continuing operations per share:		
Basic	$ 0.99	$ .81
Diluted	$ 0.96	$ .79
Net earnings available for common shareholders per share:		
Basic	$ 0.99	$ 1.12
Diluted	$ 0.96	$ 1.09
Weighted average shares outstanding:		
Basic	71,900,914	57,042,570
Diluted	74,124,531	58,849,853

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	Nine Months Ended March 31, 2004	Nine Months Ended March 31, 2003
	(thousands of dollars, except shares and per share amounts)	
Operating revenues	$ 1,513,086	$ 981,477
Cost of gas and other energy	(766,376)	(613,958)
Revenue-related taxes	(39,412)	(33,624)
Operating margin	707,298	333,895
Operating expenses:		
Operating, maintenance and general	308,777	131,823
Depreciation and amortization	89,450	43,072
Taxes, other than on income and revenues	39,350	19,145
Total operating expenses	437,577	194,040
Net operating revenues	269,721	139,855
Other income (expense):		
Interest	(97,655)	(61,583)
Dividends on preferred securities of subsidiary trust	--	(7,110)
Other, net	5,772	18,949
Total other expenses, net	(91,883)	(49,744)
Earnings from continuing operations before income taxes	177,838	90,111
Federal and state income taxes	67,756	34,544
Net earnings from continuing operations	110,082	55,567
Discontinued operations:		
Earnings from discontinued operations before income taxes	--	84,773
Federal and state income taxes	--	53,517
Net earnings from discontinued operations	--	31,256
Net earnings	110,082	86,823
Preferred stock dividends	(8,345)	--
Net earnings available for common shareholders	$ 101,737	$ 86,823
Net earnings available for common shareholders from continuing operations per share:		
Basic	$ 1.42	$ .98
Diluted	$ 1.38	$ .95
Net earnings available for common shareholders per share:		
Basic	$ 1.42	$ 1.53
Diluted	$ 1.38	$ 1.48
Weighted average shares outstanding:		
Basic	71,798,748	56,821,666
Diluted	73,904,350	58,730,594

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

ASSETS

	March 31, 2004	June 30, 2003
	(thousands of dollars)	
Property, plant and equipment:		
Plant in service	$ 3,768,894	$ 3,710,541
Construction work in progress	141,696	75,484
	3,910,590	3,786,025
Less accumulated depreciation and amortization	(722,019)	(641,225)
Net property, plant and equipment	3,188,571	3,144,800
Current assets:		
Cash and cash equivalents	71,584	86,997
Accounts receivable, billed and unbilled, net	335,299	192,402
Federal and state taxes receivable	25,382	6,787
Inventories	96,979	173,757
Deferred gas purchase costs	9,209	24,603
Gas imbalances – receivable	17,174	34,911
Prepayments and other	27,916	18,971
Total current assets	583,543	538,428
Goodwill, net	642,921	642,921
Deferred charges	185,910	188,261
Investment securities, at cost	8,038	9,641
Other	65,012	73,674
Total assets	$ 4,673,995	$ 4,597,725

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET (Continued)

STOCKHOLDERS' EQUITY AND LIABILITIES

	March 31, 2004	June 30, 2003
	(thousands of dollars)	
Stockholders' equity:		
Common stock, $1 par value; authorized 200,000,000 shares; issued 73,387,859 shares	$ 73,388	$ 73,074
Preferred stock, no par value; authorized 6,000,000 shares; issued 920,000 shares	230,000	--
Premium on capital stock	903,972	909,191
Less treasury stock, 282,333 shares at cost	(10,467)	(10,467)
Less common stock held in trust	(17,286)	(15,617)
Deferred compensation plans	11,629	9,960
Accumulated other comprehensive income (loss)	(63,891)	(62,579)
Retained earnings	118,593	16,856
Total stockholders' equity	1,245,938	920,418
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated notes of Southern Union	--	100,000
Long-term debt and capital lease obligation	2,188,820	1,611,653
Total capitalization	3,434,758	2,632,071
Current liabilities:		
Long-term debt and capital lease obligation due within one year	99,501	734,752
Notes payable	75,500	251,500
Accounts payable	138,956	112,840
Federal, state and local taxes	36,845	13,530
Accrued interest	25,448	40,871
Customer deposits	12,589	12,585
Gas imbalances – payable	40,872	64,519
Other	128,462	130,196
Total current liabilities	558,173	1,360,793
Deferred credits and other	310,647	322,154
Accumulated deferred income taxes	370,417	282,707
Total stockholders' equity and liabilities	$ 4,673,995	$ 4,597,725

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock, $1 Par Value	Premium on Capital Stock	Preferred Stock, No Par Value	Treasury Stock, at Cost	Common Stock Held in Trust	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
	(thousands of dollars)							
Balance July 1, 2002	$ 58,055	$ 707,912	$ –	$ (57,673)	$ (8,448)	$ (14,500)	$ –	$ 685,346
Comprehensive income (loss):								
Net earnings	–	–	–	–	–	–	76,189	76,189
Unrealized loss in investment securities, net of tax benefit	–	–	–	–	–	(581)	–	(581)
Minimum pension liability adjustment, net of tax benefit	–	–	–	–	–	(41,930)	–	(41,930)
Unrealized loss on hedging activities, net of tax benefit	–	–	–	–	–	(5,568)	–	(5,568)
Comprehensive income								28,110
Payment on note receivable	–	305	–	–	–	–	–	305
Purchase of treasury stock	–	–	–	(2,181)	–	–	–	(2,181)
5% stock dividend	3,468	55,832	–	–	–	–	(59,333)	(33)
Stock compensation plan	–	480	–	–	737	–	–	1,217
Issuance of stock for acquisition	–	–	–	48,900	–	–	–	48,900
Issuance of common stock	10,925	157,757	–	–	–	–	–	168,682
Issuance costs of equity units	–	(3,443)	–	–	–	–	–	(3,443)
Contract adjustment payment	–	(11,713)	–	–	–	–	–	(11,713)
Sale of common stock held in trust	–	(243)	–	–	2,424	–	–	2,181
Exercise of stock options	626	2,304	–	487	(370)	–	–	3,047
Balance June 30, 2003	73,074	909,191	–	(10,467)	(5,657)	(62,579)	16,856	920,418
Comprehensive income (loss):								
Net earnings	–	–	–	–	–	–	110,082	110,082
Preferred stock dividends	–	–	–	–	–	–	(8,345)	(8,345)
Unrealized loss in investment securities, net of tax benefit	–	–	–	–	–	(21)	–	(21)
Unrealized loss on hedging activities, net of tax benefit	–	–	–	–	–	(1,291)	–	(1,291)
Comprehensive income								100,425
Issuance of preferred stock	–	(6,790)	230,000	–	–	–	–	223,210
Exercise of stock options	314	1,571	–	–	–	–	–	1,885
Balance March 31, 2004	$ 73,388	$ 903,972	$ 230,000	$ (10,467)	$ (5,657)	$ (63,891)	$ 118,593	$ 1,245,938

The Company's common stock is $1 par value. Therefore, the change in *Common Stock, $1 Par Value* is equivalent to the change in the number of shares of common stock outstanding.

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
	(thousands of dollars)	
Cash flows from (used in) operating activities:		
Net earnings available for common shareholders	$ 71,026	$ 63,899
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortization	26,419	14,621
Amortization of debt premium	(2,693)	–
Deferred income taxes	54,309	68,521
Provision for bad debts	5,844	2,634
Gain on sale of assets	–	(62,992)
Other	27	842
Changes in operating assets and liabilities, net of acquisitions and dispositions:		
Accounts receivable, billed and unbilled	(31,185)	(61,861)
Gas imbalance receivable	17,274	–
Accounts payable	(4,841)	3,760
Gas imbalance payable	(34,015)	–
Customer deposits	(245)	(90)
Deferred gas purchase costs	17,236	(3,257)
Inventories	134,895	82,403
Deferred charges and credits	12,499	(15,621)
Prepaids and other current assets	4,448	(1,544)
Dividends payable on preferred stock	289	–
Federal and state taxes receivable	(2,914)	–
Federal, state and local taxes payable	450	3,245
Other liabilities	(29,553)	11,750
Net cash flows from operating activities	239,270	106,310
Cash flows from (used in) investing activities:		
Additions to property, plant and equipment	(43,331)	(11,512)
Proceeds from sale of assets	–	420,000
Notes receivable	(1,000)	–
Customer advances	(245)	59
Other	(4,287)	–
Net cash flows (used in) from investing activities	(48,863)	408,547
Cash flows from (used in) financing activities:		
Issuance of long-term debt	200,000	–
Issuance costs of preferred stock	(377)	–
Issuance cost of debt	(862)	(260)
Repayment of debt	(162,691)	(26,229)
Net payments under revolving credit facilities	(176,500)	(80,200)
Proceeds from exercise of stock options	797	604
Net cash flows used in financing activities	(139,633)	(106,085)
Change in cash and cash equivalents	50,774	408,772
Cash and cash equivalents at beginning of period	20,810	–
Cash and cash equivalents at end of period	$ 71,584	$ 408,772
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 47,936	$ 21,940
Income taxes	$ 52	$ 2,126

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Nine Months Ended March 31, 2004	Nine Months Ended March 31, 2003
	(thousands of dollars)	
Cash flows from (used in) operating activities:		
Net earnings available for common shareholders	$ 101,737	$ 86,823
Adjustments to reconcile net earnings to net cash flows from (used in) operating activities:		
Depreciation and amortization	89,450	43,072
Amortization of debt premium	(9,694)	–
Deferred income taxes	80,028	67,401
Provision for bad debts	13,831	9,031
Provision for impairment of other assets	2,753	–
Gain on extinguishment of debt	(6,123)	–
Gain on sale of assets	(32)	(62,992)
Net cash used in assets held for sale	–	(23,698)
Other	534	2,663
Changes in operating assets and liabilities, net of acquisitions and dispositions:		
Accounts receivable, billed and unbilled	(152,170)	(190,027)
Gas imbalance receivable	25,211	–
Accounts payable	26,116	61,207
Gas imbalance payable	(32,485)	–
Customer deposits	4	(768)
Deferred gas purchase costs	15,394	(12,444)
Inventories	77,493	76,140
Deferred charges and credits	11,105	(11,422)
Prepaids and other current assets	11,013	2,640
Dividends payable on preferred stock	4,293	–
Federal and state taxes receivable	18,121	–
Federal, state and local taxes payable	10,505	23,294
Other liabilities	(56,594)	17,394
Net cash flows from operating activities	230,490	88,314
Cash flows from (used in) investing activities:		
Additions to property, plant and equipment	(154,422)	(49,618)
Changes in assets and liabilities held for sale	–	(13,410)
Notes receivable	(2,000)	(6,750)
Proceeds from sale of assets	–	420,000
Customer advances	(3,054)	677
Other	(820)	(1,664)
Net cash flows (used in) from investing activities	(160,296)	349,235
Cash flows from (used in) financing activities:		
Issuance of long-term debt	750,000	311,087
Issuance of preferred stock	230,000	–
Issuance cost of debt	(4,858)	(1,627)
Issuance costs of preferred stock	(6,790)	–
Repayment of debt and capital lease obligation	(879,844)	(419,283)
Net (payments) borrowings under revolving credit facilities	(176,000)	78,000
Proceeds from exercise of stock options	1,885	3,046
Net cash flows used in financing activities	(85,607)	(28,777)
Change in cash and cash equivalents	(15,413)	408,772
Cash and cash equivalents at beginning of period	86,997	–
Cash and cash equivalents at end of period	$ 71,584	$ 408,772
Supplemental disclosures of cash flow information:		
Cash paid (refunded) during the period for:		
Interest	$ 121,623	$ 70,101
Income taxes	$ (6)	$ 2,003

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FINANCIAL STATEMENTS

These interim financial statements should be read in conjunction with the financial statements and notes thereto contained in Southern Union Company's (*Southern Union* and together with its subsidiaries, the *Company*) Annual Report on Form 10-K for the fiscal year ended June 30, 2003. All dollar amounts in the tables herein, except per share amounts, are stated in thousands unless otherwise indicated. Certain prior period amounts have been reclassified to conform with the current period presentation.

These interim financial statements are unaudited but, in the opinion of management, reflect all adjustments (including both normal recurring as well as any non-recurring) necessary for a fair presentation of the results of operations for such periods. Because of the seasonal nature of the Company's operations, as well as the timing of significant acquisitions and sales of operations (see *Acquisitions and Sales*, below), the results of operations and cash flows for any interim period are not necessarily indicative of results for the full year.

SIGNIFICANT ACCOUNTING POLICIES

Effective July 1, 2002, the Company adopted the Financial Accounting Standards Board (*FASB*) standard, *Accounting for Asset Retirement Obligations (ARO)*. The Statement requires legal obligations associated with the retirement of long-lived assets to be recognized at their fair value at the time the obligations are incurred. Upon initial recognition of a liability, costs should be capitalized as part of the related long-lived asset and allocated to expense over the useful life of the asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related long-lived asset. In certain rate jurisdictions, the Company is permitted to include annual charges for cost of removal in its regulated cost of service rates charged to customers. The adoption of the Statement did not have a material impact on the Company's financial position, results of operations or cash flows for all periods presented.

Panhandle Eastern Pipe Line Company, LLC (*Panhandle Eastern Pipe Line* and together with its subsidiaries, *Panhandle Energy*) has an ARO liability relating to the retirement of certain of its offshore lateral lines with an aggregate carrying amount of approximately $7,629,000 and $6,757,000 as of March 31, 2004 and June 30, 2003, respectively. During the nine-month period ended March 31, 2004, changes in the carrying amount of the ARO liability were attributable to $358,000 of additional liabilities incurred and $514,000 of accretion expense. Liabilities settled and cash flow revisions were nil for the current period.

In April 2003, the FASB issued *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. The Statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Statement (i) clarifies under what circumstances a contract with an initial net investment meets the characteristics of a derivative, (ii) clarifies when a derivative contains a financing component, (iii) amends the definition of an underlying to conform it to language used in FASB Interpretation *Guarantor's Accounting and Disclosure Requirement for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, and (iv) amends certain other existing pronouncements. The Statement is not expected to materially change the methods the Company uses to account for and report its derivatives and hedging activities.

Effective July 1, 2003, the Company adopted the FASB standard, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. The Statement establishes guidelines on how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The Statement further defines and requires that certain instruments within its scope be classified as liabilities on the financial statements. The adoption of the Statement did not have a material impact on the Company's financial position, results of operations or cash flows for all periods presented.

In December 2003, the FASB issued *Employers' Disclosures about Pensions and Other Postretirement Benefits – an amendment of FASB Statements No. 87, 88, and 106*. The Statement revises employers' disclosures about pension plans and other postretirement benefit plans. It retains the disclosure requirements contained in FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*, which it replaces, and requires additional disclosure about the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The Statement does not change the measurement or recognition of those plans required by FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination*

Benefits, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. The Statement is effective for fiscal years ending after December 15, 2003. The interim-period disclosures required by the Statement are effective for interim periods beginning after December 15, 2003.

In December 2003, the FASB issued *Consolidation of Variable Interest Entities*. The Interpretation introduced a new consolidation model, which determines control and consolidation based on potential variability in gains and losses of the entity being evaluated for consolidation. The Interpretation requires a company to consolidate a variable interest entity if the company is allocated a majority of the entity's gains and/or losses, including fees paid by the entity. The Interpretation is effective for companies that have an interest in variable interest entities or potential variable interest entities commonly referred to as special-purpose entities for periods ending after December 15, 2003. Application by companies for all other types of entities is required in financial statements for periods ending after March 15, 2004. The Company has not identified any material variable interest entities or interests in variable interest entities for which the provisions of this Interpretation would require a change in the Company's current accounting for such interests.

In March 2004, the Emerging Issues Task Force (*EITF*) reached final consensuses on Issue 03-6, *Participating Securities and the Two-Class Method under FASB 128, Earnings per Share*. The Issue addresses the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The Issue is effective for interim periods beginning after March 31, 2004. The Company continues to assess this Issue but does not anticipate that it will materially impact the methods the Company uses to calculate its earning per share.

ACQUISITIONS AND SALES

On June 11, 2003, Southern Union acquired Panhandle Energy from CMS Energy Corporation for approximately $581,729,000 in cash and 3,000,000 shares of Southern Union common stock (before adjustment for subsequent stock dividends) valued at approximately $48,900,000 based on market prices at closing of the Panhandle Energy acquisition and in connection therewith incurred transaction costs of approximately $30,448,000. Southern Union also incurred additional deferred state income tax liabilities estimated at $10,597,000 as a result of the transaction. At the time of the acquisition, Panhandle Energy had approximately $1,157,228,000 of debt principal outstanding that it retained. The Company funded the cash portion of the acquisition with approximately $437,000,000 in cash proceeds it received for the January 1, 2003 sale of its Texas operations, approximately $121,250,000 of the net proceeds it received from concurrent common stock and equity unit offerings and with working capital available to the Company. The Company structured the Panhandle Energy acquisition and the sale of its Texas operations to qualify as a like-kind exchange of property under Section 1031 of the Internal Revenue Code of 1986, as amended. The acquisition was accounted for using the purchase method of accounting in accordance with accounting principles generally accepted in the United States of America by allocating the purchase price and acquisition costs incurred by the Company to Panhandle Energy's net assets as of the acquisition date. The Panhandle Energy assets acquired and liabilities assumed have been recorded at their estimated fair value as of the acquisition date based on the results of outside appraisals. Items which are still under review are the valuation of certain contingent liabilities as of the acquisition date. Panhandle Energy's results of operations have been included in the Consolidated Statement of Operations since June 11, 2003. Thus, the Consolidated Statement of Operations for the periods subsequent to the acquisition is not comparable to the same periods in prior years.

Panhandle Energy is primarily engaged in the interstate transportation and storage of natural gas and also provides liquefied natural gas (*LNG*) terminalling and regasification services and is subject to the rules and regulations of the Federal Energy Regulatory Commission (*FERC*). The Panhandle Energy entities include Panhandle Eastern Pipe Line Company, LLC (*Panhandle Eastern Pipe Line*), Trunkline Gas Company, LLC (*Trunkline*) a wholly-owned subsidiary of Panhandle Eastern Pipe Line, Sea Robin Pipeline Company (*Sea Robin*), a Louisiana unincorporated joint venture and an indirect wholly-owned subsidiary of Panhandle Eastern Pipe Line, Trunkline LNG Company, LLC (*Trunkline LNG*) which is a wholly-owned subsidiary of Trunkline LNG Holdings, LLC (*LNG Holdings*) an indirect wholly-owned subsidiary of Panhandle Eastern Pipe Line and Pan Gas Storage, LLC (d.b.a. *Southwest Gas Storage*) a wholly-owned subsidiary of Panhandle Eastern Pipe Line. Collectively, the pipeline assets include more than 10,000 miles of interstate pipelines that transport natural gas from the Gulf of Mexico, South Texas and the Panhandle regions of Texas and Oklahoma to major U.S. markets in the Midwest and Great Lakes region. The pipelines have a combined peak day delivery capacity of 5.4 billion cubic feet (*Bcf*) per day and 72 Bcf of owned underground storage

capacity. Trunkline LNG, located on Louisiana's Gulf Coast, operates one of the largest LNG import terminals in North America and has 6.3 Bcf of above ground LNG storage capacity.

The following table summarizes the estimated fair values of the Panhandle Energy assets acquired and liabilities assumed at the date of acquisition.

	At June 11, 2003
Property, plant and equipment (excluding intangibles)	$ 1,913,535
Intangibles	21,293
Current assets (1)	217,647
Other non-current assets	29,800
Total assets acquired	2,182,275
Long-term debt	(1,207,617)
Current liabilities	(170,193)
Other non-current liabilities	(132,791)
Total liabilities assumed	(1,510,601)
Net assets acquired	$ 671,674

(1) Includes cash and cash equivalents of approximately $59 million.

Effective January 1, 2003, the Company completed the sale of its Southern Union Gas natural gas operating division and related assets to ONEOK, Inc. (*ONEOK*) for approximately $437,000,000 in cash resulting in a pre-tax gain of $62,992,000. In accordance with accounting principles generally accepted in the United States of America, the results of operations and gain on sale of the Texas operations have been segregated and reported as "discontinued operations" in the Consolidated Statement of Operations and as "assets held for sale" in the Consolidated Statement of Cash Flows for the respective periods.

Pro Forma Financial Information

The following unaudited pro forma financial information for the three- and nine-month periods ended March 31, 2003 is presented as though the following events had occurred at the beginning of the periods presented: (i) acquisition of Panhandle Energy; and (ii) the issuance of the common stock and equity units in June 2003. The pro forma financial information is not necessarily indicative of the results which would have actually been obtained had the acquisition of Panhandle Energy or the issuance of the common stock and equity units been completed as of the assumed date for the periods presented or which may be obtained in the future.

	Three Months Ended March 31, 2003	Nine Months Ended March 31, 2003
Operating revenues	$ 672,300	$ 1,367,084
Net earnings from continuing operations	73,304	126,774
Net earnings per share from continuing operations:		
Basic	1.02	1.77
Diluted	1.00	1.73

OTHER INCOME

On August 6, 2002, Southwest Gas Corporation (*Southwest*) agreed to pay Southern Union $17,500,000 to settle the Company's claims of fraud and bad faith breach of contract related to Southern Union's attempts to purchase Southwest. Effective January 1, 2003, ONEOK agreed to pay Southern Union $5,000,000 to settle the Company's claims related to ONEOK's blocked acquisition of Southwest. The settlements resulted in a pre-tax gain and cash flow of $5,000,000 and $22,500,000, respectively, for the three-month and nine-month periods ended March 31, 2003.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

EARNINGS PER SHARE

The following table summarizes the Company's basic and diluted earnings per share calculations for the three- and nine-month periods ended March 31, 2004 and 2003:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2004	2003	2004	2003
Net earnings available for common shareholders from continuing operations (1)	$ 71,026	$ 46,234	$ 101,737	$ 55,567
Net earnings from discontinued operations	–	17,665	–	31,256
Net earnings available for common shareholders	$ 71,026	$ 63,899	$ 101,737	$ 86,823
Weighted average shares outstanding – basic	71,900,914	57,042,570	71,798,748	56,821,666
Weighted average shares outstanding – diluted	74,124,531	58,849,853	73,904,350	58,730,594
Basic earnings per share:				
Net earnings available for common shareholders from continuing operations (1)	$ 0.99	$ 0.81	$ 1.42	$ 0.98
Net earnings from discontinued operations	–	0.31	–	0.55
Net earnings available for common shareholders	$ 0.99	$ 1.12	$ 1.42	$ 1.53
Diluted earnings per share:				
Net earnings available for common shareholders from continuing operations (1)	$ 0.96	$ 0.79	$ 1.38	$ 0.95
Net earnings from discontinued operations	–	0.30	–	0.53
Net earnings available for common shareholders	$ 0.96	$ 1.09	$ 1.38	$ 1.48

(1) Includes $4,341,000 and $8,345,000 of preferred stock dividends for the three- and nine-month periods ended March 31, 2004.

Diluted earnings per share includes average shares outstanding as well as common stock equivalents from stock options, warrants and mandatory convertible equity units. Common stock equivalents were 1,092,331 and 569,088 for the three-month periods ended March 31, 2004 and 2003, respectively, and 996,128 and 665,772 for the nine-month periods ended March 31, 2004 and 2003, respectively.

Stock options to purchase 138,900 shares of common stock were outstanding during the nine-month period ended March 31, 2004, and stock options to purchase 2,263,905 shares of common stock were outstanding during the three- and nine-month periods ended March 31, 2003, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares during the respective period. There were no "anti-dilutive" options outstanding for the three-month period ended March 31, 2004. At March 31, 2004, 1,146,868 shares of common stock were held by various rabbi trusts for certain of the Company's benefit plans and 105,710 shares were held in a rabbi trust for certain employees who deferred receipt of Company shares for stock options exercised. From time to time, the Company's benefit plans may purchase shares of Southern Union common stock subject to regular restrictions.

On June 11, 2003, the Company issued 2,500,000 mandatory convertible equity units at a public offering price of $50.00 per share. Each equity unit consists of a $50.00 principal amount of the Company's 2.75% Senior Notes due 2006 (see *Debt and Capital Lease*) and a forward stock purchase contract that obligates the holder to purchase Company common stock on August 16, 2006, at a price based on the preceding 20-day average closing price (subject to a minimum and maximum conversion price per share of $15.24 and $18.59, respectively, which are subject to adjustments for future stock splits or stock dividends). The Company will issue between 6,723,873 shares and 8,203,125 shares of its common stock (also subject to adjustments for future stock splits or stock dividends) upon the consummation of the forward purchase contract. Until the conversion date, the equity units will have a dilutive effect on earnings per share if the Company's average common stock price for the period exceeds the maximum conversion price. For the three- and nine-month periods ended March 31, 2004, diluted earnings per share included common stock equivalents from mandatory convertible equity units of 29,214 and nil, respectively.

GOODWILL AND INTANGIBLES

There was no change in the carrying amount of goodwill for the nine-month period ended March 31, 2004. As of March 31, 2004, the Company has goodwill of $642,921,000 from its Distribution segment. The Distribution segment is tested annually for impairment in the fourth quarter, after the annual forecasting process.

On June 11, 2003, the Company completed its acquisition of Panhandle Energy. Based on the purchase price allocations, which rely on estimates and outside appraisals, the acquisition resulted in no recognition of goodwill as of the acquisition date. In addition, based on the purchase price allocations the acquisition resulted in the recognition of intangible assets relating to customer contracts and relationships of approximately $21,293,000 as of the acquisition date. These intangibles are currently being amortized over a period of twenty years, the remaining life of the contract for which the value is associated. As of March 31, 2004, the carrying amount of these intangibles was approximately $20,027,000 and is included in Property, Plant and Equipment on the Consolidated Balance Sheet.

DEFERRED CHARGES AND CREDITS

	March 31, 2004	June 30, 2003
Deferred Charges		
Pensions	$ 39,128	$ 39,088
Unamortized debt expense	38,083	34,209
Income taxes	31,441	30,514
Retirement costs other than pensions	26,741	29,028
Environmental	17,569	14,304
Service Line Replacement program	17,483	18,974
Other	15,465	22,144
Total Deferred Charges	$ 185,910	$ 188,261

As of March 31, 2004 and June 30, 2003, the Company's deferred charges include regulatory assets relating to Distribution segment operations in the aggregate amount of $107,256,000 and $109,160,000, respectively, of which $70,196,000 and $75,381,000, respectively, is being recovered through current rates. As of March 31, 2004 and June 30, 2003, the remaining recovery period associated with these assets ranges from 1 to 208 months and from 6 months to 147 months, respectively. None of these regulatory assets, which primarily relate to pensions, retirement costs other than pensions, income taxes, Year 2000 costs, Missouri Gas Energy's Service Line Replacement program and environmental remediation costs, are included in rate base. The Company records regulatory assets in accordance with the FASB standard, *Accounting for the Effects of Certain Types of Regulation.*

	March 31, 2004	June 30, 2003
Deferred Credits		
Pensions	$ 96,076	$ 88,016
Retirement costs other than pensions	62,679	65,144
Environmental	29,569	32,322
Cost of Removal	28,110	27,286
Derivative liability	14,859	26,151
Customer advances for construction	12,530	12,008
Self-insurance	11,787	12,000
Investment tax credit	5,346	5,661
Other	49,691	53,566
Total Deferred Credits	$ 310,647	$ 322,154

The Company's deferred credits include regulatory liabilities relating to Distribution segment operations in the aggregate amount of $10,883,000 and $10,084,000, respectively, at March 31, 2004, and June 30, 2003. These regulatory liabilities primarily relate to retirement benefits other than pensions, environmental insurance recoveries and income taxes. The Company records regulatory liabilities in accordance with the FASB standard, *Accounting for the Effects of Certain Types of Regulation.*

INVESTMENT SECURITIES

As of March 31, 2004, all securities owned by Southern Union are accounted for under the cost method. The Company's investments in securities consist of common and preferred stock in non-public companies whose value is not readily determinable. Various Southern Union executive management personnel, Board of Directors and employees also have an equity ownership in one of these investments.

The Company reviews its portfolio of investment securities on a quarterly basis to determine whether a decline in value is other than temporary. Factors that are considered in assessing whether a decline in value is other than temporary include, but are not limited to: earnings trends and asset quality; near term prospects and financial condition of the issuer, including the availability and terms of any additional financing requirements; financial condition and prospects of the issuer's region and industry, customers and markets and Southern Union's intent and ability to retain the investment. If Southern Union determines that the decline in value of an investment security is other than temporary, the Company will record a charge on its Consolidated Statement of Operations to reduce the carrying value of the security to its estimated fair value.

In September 2003, Southern Union determined that the decline in value of its investment in PointServe was other than temporary. Accordingly, the Company recorded a non-cash charge of $1,603,000 to reduce the carrying value of this investment to its estimated fair value. The Company recognized this valuation adjustment to reflect lower private equity valuation metrics and changes in the business outlook of PointServe. PointServe is a closely held, privately owned company and, as such, has no published market value. The Company's remaining investment of $2,603,000 at March 31, 2004 is carried at its estimated fair value and may be subject to future market value risk. The Company will continue to monitor the value of its investment and periodically assess the impact, if any, on reported earnings in future periods.

STOCKHOLDERS' EQUITY

The Company accounts for its incentive plans under the Accounting Principles Board Opinion, *Accounting for Stock Issued to Employees* and related authoritative interpretations. The Company recorded no compensation expense for the three- and nine-month periods ended March 31, 2004 and 2003. During 1997, the Company adopted the FASB Standard, *Accounting for Stock-Based Compensation*, for footnote disclosure purposes only. Had compensation cost for these incentive plans been determined consistent with this Statement, the Company's net earnings available for common shareholders from continuing operations and diluted earnings per share would have been $70,541,000 and $.95, and $45,967,000 and $.78, respectively, for the three-month periods ended March 31, 2004 and 2003, and $100,516,000 and $1.36, and $54,508,000 and $.93, respectively, for the nine-month periods ended March 31, 2004 and 2003. Had compensation cost for these incentive plans been determined consistent with this Statement, the Company's net earnings available for common shareholders and diluted earnings per share would have been $70,541,000 and $.95, and $63,632,000 and $1.08, respectively, for the three-month periods ended March 31, 2004 and 2003, and $100,516,000 and $1.36, and $85,764,000 and $1.46, respectively, for the nine-month periods ended March 31, 2004 and 2003.

COMPREHENSIVE INCOME

The table below gives an overview of comprehensive income for the periods indicated.

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2004	2003	2004	2003
Net earnings available for common shareholders	$ 71,026	$ 63,899	$101,737	$ 86,823
Other comprehensive income (loss):				
Unrealized loss in investment securities, net of tax benefit	–	(82)	(21)	(428)
Unrealized loss on hedging activities, net of tax benefit	(2,011)	(1,943)	(1,291)	(1,814)
Minimum pension liability adjustment, net of tax	–	4,178	–	4,178
Other comprehensive (loss) income	(2,011)	2,153	(1,312)	1,936
Comprehensive income	$ 69,015	$ 66,052	$100,425	$ 88,759

Accumulated other comprehensive income reflected in the Consolidated Balance Sheet at March 31, 2004, includes unrealized gains and losses on hedging activities and minimum pension liability adjustments.

DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company utilizes derivative instruments on a limited basis to manage certain business risks. Interest rate swaps and treasury rate locks are employed to manage the Company's exposure to interest rate risk.

Cash Flow Hedges. As a result of the acquisition of Panhandle Energy, the Company is party to interest rate swap agreements with an aggregate notional amount of $199,963,000 as of March 31, 2004 that fix the interest rate applicable to floating rate long-term debt and which qualify for hedge accounting. For the nine-month period ended March 31, 2004, the amount of swap ineffectiveness was not significant. As of March 31, 2004, floating rate London InterBank Offered Rate (*LIBOR*) based interest payments were exchanged for weighted fixed rate interest payments of 5.88%, which does not include the spread on the underlying variable debt rate of 1.625%. As such, payments or receipts on interest rate swap agreements, in excess of the liability recorded, are recognized as adjustments to interest expense. As of March 31, 2004 and June 30, 2003, the fair value liability position of the swaps was $21,221,000 and $26,850,000, respectively. As of March 31, 2004 and since the acquisition date, an unrealized loss of $1,472,000 ($881,000, net of tax), was included in accumulated other comprehensive income related to these swaps, of which approximately $314,000, net of tax, is expected to be reclassified to interest expense during the next twelve months, as the hedged interest payments occur. Current market pricing models were used to estimate fair values of interest rate swap agreements.

The Company was also party to an interest rate swap agreement with a notional amount of $8,199,000 at June 30, 2003 that fixed the interest rate applicable to floating rate long-term debt and which qualified for hedge accounting. The fair value liability position of the swap was $93,000 at June 30, 2003. In October 2003, the swap expired and $15,000 of unrealized after-tax losses included in accumulated other comprehensive income relating to this swap was reclassified to interest expense during the quarter ended December 31, 2003.

In March and April 2003, the Company entered into a series of treasury rate locks with an aggregate notional amount of $250,000,000 to manage its exposure against changes in future interest payments attributable to changes in the benchmark interest rate prior to the anticipated issuance of fixed-rate debt. These treasury rate locks expired on June 30, 2003, resulting in a $6,862,000 after-tax loss that was recorded in accumulated other comprehensive income and will be amortized into interest expense over the lives of the associated debt instruments. As of March 31, 2004, approximately $846,000 of net after-tax losses in accumulated other comprehensive income will be amortized into interest expense during the next twelve months.

The notional amounts of the interest rate swaps are not exchanged and do not represent exposure to credit loss. In the event of default by a counterparty, the risk in these transactions is the cost of replacing the agreements at current market rates.

Fair Value Hedges. In March 2004, Panhandle Energy entered into an interest rate swap to hedge the risk associated with the fair value of its $200,000,000 2.75% Senior Notes. These swaps are designated as fair value hedges and qualify for the short cut method under FASB standard, *Accounting for Derivative Instruments and Hedging Activities,* as amended. Under the swap agreement Panhandle Energy will receive fixed interest payments at a rate of 2.75% and will make floating interest payments based on the six-month LIBOR. No ineffectiveness is assumed in the hedging relationship between the debt instrument and the interest rate swap.

Trading and Non-Hedging Activities. During fiscal 2004, the Company acquired natural gas commodity swap derivatives and collar transactions in order to mitigate price volatility of natural gas passed through to utility customers. The cost of the derivative products and the settlement of the respective obligations are recorded through the gas purchase adjustment clause as authorized by the applicable regulatory authority and therefore do not impact earnings. The fair value of the contracts is recorded as an adjustment to a regulatory asset/ liability in the Consolidated Balance Sheet. As of March 31, 2004, the fair values of the contracts, which expire at various times through October 2004, are included in the Consolidated Balance Sheet as an asset and a matching adjustment to deferred cost of gas of $1,238,000.

PREFERRED SECURITIES

On May 17, 1995, Southern Union Financing I (*Subsidiary Trust*), a consolidated wholly-owned subsidiary of Southern Union, issued $100,000,000 of 9.48% Trust Originated Preferred Securities (*Preferred Securities*). In connection with the Subsidiary Trust's issuance of the Preferred Securities and the related purchase by Southern Union of all of the Subsidiary Trust's common securities (*Common Securities*), Southern Union issued to the Subsidiary Trust $103,092,800 principal amount of its 9.48% Subordinated Deferrable Interest Notes, due 2025 (*Subordinated Notes*).

The sole assets of the Subsidiary Trust are the Subordinated Notes. On October 1, 2003, the Company called the Subordinated Notes for redemption, and the Subordinated Notes and the Preferred Securities were redeemed on October 31, 2003. The Company financed the redemption with borrowings under its revolving credit facilities, which were paid down with the net proceeds of a $230,000,000 offering of preferred stock by the Company on October 8, 2003, as further described below.

On October 8, 2003, the Company issued 920,000 shares of its 7.55% Noncumulative Preferred Stock, Series A (Liquidation Preference $250 Per Share) to the public through the issuance of 9,200,000 Depositary Shares, each representing a one-tenth interest in a 7.55% Noncumulative Preferred Stock, Series A share at the public offering price of $25.00 per share, or $230,000,000 in the aggregate. The total net proceeds were used to repay debt under the Company's revolving credit facilities.

DEBT AND CAPITAL LEASE

	March 31, 2004	June 30, 2003
Southern Union Company		
7.60% Senior Notes, due 2024	$ 359,765	$ 359,765
8.25% Senior Notes, due 2029	300,000	300,000
2.75% Senior Notes, due 2006	125,000	125,000
Term Note, due 2005	136,087	211,087
6.50% to 10.25% First Mortgage Bonds, due 2008 to 2029	113,439	115,884
7.70% Debentures, due 2027	–	6,756
Capital lease and other due 2004 to 2007	315	9,179
	1,034,606	1,127,671
Panhandle Energy		
2.75% Senior Notes due 2007	200,000	–
4.80% Senior Notes due 2008	300,000	–
6.05% Senior Notes due 2013	250,000	–
6.125% Senior Notes due 2004	–	292,500
7.875% Senior Notes due 2004	52,455	100,000
6.50% Senior Notes due 2009	60,623	158,980
8.25% Senior Notes due 2010	40,500	60,000
7.00% Senior Notes due 2029	66,305	135,890
Term Loan due 2007	266,614	275,358
7.95% Debentures due 2023	–	76,500
7.20% Debentures due 2024	–	58,000
Net premiums on long-term debt	17,218	61,506
	1,253,715	1,218,734
Total consolidated debt and capital lease	2,288,321	2,346,405
Less current portion	99,501	734,752
Total consolidated long-term debt and capital lease	$ 2,188,820	$ 1,611,653

Each note, debenture or bond is an obligation of Southern Union Company or a unit of Panhandle Energy, as noted above. The Panhandle Energy Term Loan due 2007 is debt related to Panhandle's Trunkline LNG Holdings subsidiary, and is non-recourse to other units of Panhandle Energy or Southern Union Company. The remainder of Panhandle Energy's debt is non-recourse to Southern Union. All debts that are listed as debt of Southern Union Company are direct obligations of Southern Union Company, and no debt is cross-collateralized.

The Company is not party to any lending agreement that would accelerate the maturity date of any obligation due to a failure to maintain any specific credit rating. Certain covenants exist in certain of the Company's debt agreements that require the Company to maintain a certain level of net worth, to meet certain debt to total capitalization ratios, and to meet certain ratios of earnings before depreciation, interest and taxes to cash interest expense. A failure by the Company to satisfy any such covenant would be considered an event of default under the associated debt, which could become immediately due and payable if the Company did not cure such default within any permitted cure period or if the Company did not obtain amendments, consents or waivers from its lenders with respect to such covenants.

Capital Lease. The Company completed the installation of an Automated Meter Reading (AMR) system at Missouri Gas Energy during the first quarter of fiscal year 1999. The installation of the AMR system involved an investment of approximately $30,000,000 which is accounted for as a capital lease obligation. The final lease payment was made on October 1, 2003, and the Company has no further obligations with respect to the capital lease.

Credit Facilities. On April 3, 2003, the Company entered into a short-term credit facility in the amount of $140,000,000 (the *Short Term Facility*), that matured April 1, 2004. The Short-Term Facility was increased to $150,000,000 as of September 25, 2003. Also on April 3, 2003, the Company amended the terms and conditions of its $225,000,000 long-term credit facility (the *Long-Term Facility*), which expires on May 29, 2004. The Company has additional availability under uncommitted line of credit facilities (*Uncommitted Facilities*) with various banks. Borrowings under the facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. The Short-Term Facility and the Long-Term Facility (together, the *Facilities*) are subject to a commitment fee based on the rating of the Senior Notes. The Company is in the process of entering a new five-year credit facility that will replace the Short Term Facility and the Long Term Facility. The Company expects that the new facility will contain substantially similar terms and conditions as the existing facilities. As of March 31, 2004, the commitment fees were an annualized 0.15% on the Facilities. The interest rate on borrowings on the Facilities is calculated based upon a formula using the LIBOR or prime interest rates. A balance of $75,500,000 was outstanding under the Facilities at March 31, 2004, at an effective weighted average interest rate of 1.92%.

Term Note. On August 28, 2000 the Company entered into the Term Note to fund (i) the cash portion of the consideration to be paid to the Fall River Gas' stockholders; (ii) the all cash consideration to be paid to the ProvEnergy and Valley Resources stockholders, (iii) repayment of approximately $50,000,000 of long- and short-term debt assumed in the mergers, and (iv) all related acquisition costs. The Term Note, which initially expired on August 27, 2001, was extended through August 26, 2002. On July 16, 2002, the Company repaid the Term Note with the proceeds from the issuance of a $311,087,000 Term Note dated July 15, 2002 (the *2002 Term Note*) and borrowings under the Company's lines of credit. The 2002 Term Note is held by a syndicate of sixteen banks, led by JPMorgan Chase Bank, as Agent. Eleven of the sixteen banks were also among the lenders of the Term Note, and they are also lenders under at least one of the Facilities. The 2002 Term Note carries a variable interest rate that is tied to either the LIBOR or prime interest rates at the Company's option. The interest rate spread over the LIBOR rate varies with the credit rating of the Senior Notes by S&P and Moody's, and is currently LIBOR plus 105 basis points. As of March 31, 2004, a balance of $136,087,000 was outstanding under this 2002 Term Note at an effective interest rate of 2.16%. The 2002 Term Note requires principal payments of $35,000,000 on February 15, 2005, $35,000,000 on August 15, 2005 and $66,087,000 on August 26, 2005. The Company made an additional voluntary prepayment under the 2002 Term Note of $25,000,000 on April 30, 2004, which will reduce the required principal payments on a pro rata basis. No additional draws can be made on the 2002 Term Note.

Panhandle Refinancing. In July 2003, Panhandle Energy announced a tender offer for any and all of the $747,370,000 outstanding principal amount of five of its series of senior notes outstanding at that point in time (the *Panhandle Tender Offer*) and also called for redemption all of the outstanding $134,500,000 principal amount of its two series of debentures that were outstanding (the *Panhandle Calls*). Panhandle Energy repurchased approximately $378,257,000 of the principal amount of its outstanding debt through the Panhandle Tender Offer for total consideration of approximately $396,445,000 plus accrued interest through the purchase date. Panhandle Energy also redeemed approximately $134,500,000 of debentures through the Panhandle Calls for total consideration of $139,411,000, plus accrued interest through the redemption dates. As a result of the Panhandle Tender Offer, the Company has recorded a pre-tax gain on the extinguishment of debt of $6,123,000 in August 2003, which has been classified as other income, net, in the Consolidated Statement of Operations. In August 2003, Panhandle Energy issued $300,000,000 of its 4.80% Senior Notes due 2008 and $250,000,000 of its 6.05% Senior Notes due 2013 principally to refinance the repurchased notes and redeemed debentures. Also in August and September 2003, Panhandle Energy repurchased $3,150,000 principal amount of its senior notes on the open market through two transactions for total consideration of $3,398,000, plus accrued interest through the repurchase date.

On March 12, 2004, Panhandle Energy issued $200,000,000 of its 2.75% Senior Notes due 2007, the proceeds of which were used to fund the redemption of the remaining $146,080,000 principal amount of its 6.125% Senior Notes due 2004 that matured on March 15, 2004 and to provide working capital to the Company, pending the repayment of the $52,455,000 principal amount of Panhandle Energy's 7.875% Senior Notes due 2004 that mature on August 15, 2004.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

EMPLOYEE BENEFITS

Components of Net Periodic Benefit Cost

Net periodic benefit cost for the three-months ended March 31, 2004 and 2003 includes the following components:

	Pension Benefits		Post-Retirement Benefits	
	2004	2003	2004	2003
Service cost	$ 1,738	$ 1,414	$ 913	$ 294
Interest cost	5,586	5,725	1,975	1,395
Expected return on plan assets	(5,244)	(6,187)	(419)	(434)
Amortization of prior service cost	263	198	19	(16)
Recognized actuarial gain (loss)	1,906	608	144	(59)
Settlement recognition	(119)	(140)	–	–
Net periodic pension cost	$ 4,130	$ 1,618	$ 2,632	$ 1,180

Net periodic benefit cost for the nine-months ended March 31, 2004 and 2003 includes the following components:

	Pension Benefits		Post-Retirement Benefits	
	2004	2003	2004	2003
Service cost	$ 5,213	$ 4,241	$ 2,738	$ 883
Interest cost	16,758	17,174	5,925	4,184
Expected return on plan assets	(15,731)	(18,562)	(1,256)	(1,301)
Amortization of prior service cost	787	593	56	(49)
Recognized actuarial gain (loss)	5,719	1,825	431	(176)
Settlement recognition	(356)	(419)	–	–
Net periodic pension cost	$ 12,390	$ 4,852	$ 7,894	$ 3,541

Employer Contributions

As of March 31, 2004, $1,509,000 and $8,857,000 of contributions have been made to the Company's pension plans and post-retirement plans, respectively. The Company presently anticipates contributing an additional $3,750,000 to fund its pension plan in fiscal 2004 for a total of $5,259,000, and $4,335,000 to fund its post-retirement plan in fiscal 2004 for a total of $13,192,000.

REGULATION AND RATES

Missouri Gas Energy. On November 4, 2003, Missouri Gas Energy filed a request with the Missouri Public Service Commission (*MPSC*) to increase base rates by $44,800,000 and to implement a weather mitigation rate design that would significantly reduce the impact of weather-related fluctuations on customer bills. On January 30, 2004, Missouri Gas Energy filed an updated claim which raised the amount of the base rate increase request to $54,200,000. Statutes require that the MPSC reach a decision in the case within an eleven-month period from the original filing date. It is not presently possible to determine what action the MPSC will ultimately take with respect to this rate increase request.

New England Gas Company. On October 30, 2003, the Rhode Island Public Utilities Commission (*RIPUC*) approved the Company's gas cost filing and allowed full recovery of the deferred fuel balance effective November 1, 2003. At the same open meeting, the RIPUC ordered the Company to begin to refund, through the Distribution Adjustment Clause, the Division of Public Utilities and Carriers position on the Company's over earnings, which were substantially accrued for by the Company at June 30, 2003, pending a final decision by the RIPUC. On April 15, 2004, RIPUC ruled on its final decision and approved total over earnings for fiscal 2003 to be $799,000, which was accrued for by the Company at March 31, 2004.

On May 22, 2003, the RIPUC approved a Settlement Offer filed by New England Gas Company related to the final calculation of earnings sharing for the 21-month period covered by the Energize Rhode Island Extension settlement agreement. This calculation generated excess revenues of $5,227,000. The net result of the excess revenues and the Energize Rhode Island weather mitigation and non-firm margin sharing provisions is the crediting to customers of $949,000 over a twelve-month period starting July 1, 2003.

Panhandle Energy. In December 2002, FERC approved a Trunkline LNG certificate application to expand the Lake Charles facility to approximately 1.2 Bcf per day of sustainable sendout capacity versus the current sustainable capacity of .63 Bcf per day and increase terminal storage capacity to 9 Bcf from the current 6.3 Bcf. BG LNG Services has contract rights for the .57 Bcf per day of additional capacity. Construction on the Trunkline LNG expansion project *(Phase I)* commenced in September 2003 and is expected to be completed with an estimated cost totaling $137 million by the end of calendar 2005. In February 2004, Trunkline LNG filed a further incremental LNG expansion project (*Phase II*) with the FERC and is awaiting Commission approval. Phase II is estimated to cost approximately $77 million, plus capitalized interest, and would increase the LNG terminal sustainable sendout capacity to 1.8 Bcf per day. Phase II has an expected in-service date of mid-2006. BG LNG Services has contracted for all the proposed additional capacity subject to Trunkline LNG achieving certain construction milestones at this facility.

In February 2004, Trunkline filed an application with the FERC to request approval of a 30-inch diameter, 23-mile natural gas pipeline loop from the LNG terminal. The estimated cost of this pipeline expansion project is $40 million. The pipeline creates additional transport capacity in association with the Trunkline LNG expansion and also includes new and expanded delivery points with major interstate pipelines.

COMMITMENTS AND CONTINGENCIES

Environmental

The Company is subject to federal, state and local laws and regulations relating to the protection of the environment. These evolving laws and regulations may require expenditures over a long period of time to control environmental impacts. The Company has established procedures for the on-going evaluation of its operations to identify potential environmental exposures and assure compliance with regulatory policies and procedures.

The Company follows the provisions of an American Institute of Certified Public Accountants Statement of Position, *Environmental Remediation Liabilities*, for recognition, measurement, display and disclosure of environmental remediation liabilities.

In certain of the Company's jurisdictions the Company is allowed to recover environmental remediation expenditures through rates. Although significant charges to earnings could be required prior to rate recovery for jurisdictions that do not have rate recovery mechanisms, management does not believe that environmental expenditures will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Local Distribution Company Environmental Matters -- The Company is investigating the possibility that the Company or predecessor companies may have been associated with Manufactured Gas Plant (*MGP*) sites in its former gas distribution service territories, principally in Texas, Arizona and New Mexico, and present gas distribution service territories in Missouri, Pennsylvania, Massachusetts and Rhode Island. At the present time, the Company is aware of certain MGP sites in these areas and is investigating those and certain other locations. While the Company's evaluation of these Texas, Missouri, Arizona, New Mexico, Pennsylvania, Massachusetts and Rhode Island MGP sites is in its preliminary stages, it is likely that some compliance costs may be identified and become subject to reasonable quantification. Within the Company's gas distribution service territories certain MGP sites are currently the subject of governmental actions. These sites are as follows:

Missouri Sites. In a letter dated May 10, 1999, the Missouri Department of Natural Resources (*MDNR*) sent notice of a planned Site Inspection/Removal Site Evaluation of the Kansas City Coal Gas Former MGP site. This site (comprised of two adjacent MGP operations previously owned by two separate companies and hereafter referred to as Station A and Station B) is located at East 1st Street and Campbell in Kansas City, Missouri and is owned by Missouri Gas Energy (*MGE*). During July 1999, the Company submitted the two sites to MDNR's Voluntary Cleanup Program (*VCP*) and, subsequently, performed environmental assessments of the sites. Following the submission of these assessments to MDNR, MGE was required by MDNR to initiate remediation of Station A. Following the selection of a qualified contractor in a competitive bidding process, the Company began remediation of Station A in the first calendar quarter of 2003. The project was completed in July 2003, at an approximate cost of $4 million. The remediation of Station B has not been required by MDNR.

Following a failed tank tightness test, MGE removed an underground storage tank system in December, 2002 from a

former MGP site in St. Joseph, Missouri. An underground storage tank closure report was filed with MDNR on August 12, 2003. In a letter dated September 26, 2003, MDNR indicated that its review of the analytical data submitted for this site indicated that contamination existed at the site above the action levels specified in Missouri guidance documents. In a letter dated January 28, 2004, MDNR indicated that the Department would provide MGE a final version of the Missouri Risk-Based Corrective Action (*MRBCA*) process as soon as it becomes available, and indicated that it would expect MGE to submit a work plan outlining site characterization activities for this site following MGE's receipt of the MRBCA.

Rhode Island and Massachusetts Sites. Prior to its acquisition by the Company, Providence Gas performed environmental studies and initiated an environmental remediation project at Providence Gas' primary gas distribution facility located at 642 Allens Avenue in Providence, Rhode Island. Providence Gas spent more than $13 million on environmental assessment and remediation at this MGP site under the supervision of the Rhode Island Department of Environmental Management (*RIDEM*). Following the acquisition, environmental remediation at the site was temporarily suspended. During this suspension, the Company requested certain modifications to the 1999 Remedial Action Work Plan from RIDEM. After receiving approval to some of the requested modifications to the 1999 Remedial Action Work Plan, environmental work was reinitiated on April 17, 2002, by a qualified contractor selected in a competitive bidding process. Remediation was completed on October 10, 2002, and a Closure Report was filed with RIDEM in December 2002. The approximate cost of the environmental work conducted after environmental work resumed was $4 million. Remediation of the remaining 37.5 acres of the site (known as the "Phase 2" remediation project) is not scheduled at this time.

In November 1998, Providence Gas received a letter of responsibility from RIDEM relating to possible contamination at a site that operated as a MGP in the early 1900's in Providence, Rhode Island. Subsequent to its use as a MGP, this site was operated for over eighty years as a bulk fuel oil storage yard by a succession of companies including Cargill, Inc. (*Cargill*). Cargill has also received a letter of responsibility from RIDEM for the site. An investigation has begun to determine the extent of contamination, as well as the extent of the Company's responsibility. Providence Gas entered into a cost-sharing agreement with Cargill, under which Providence Gas is responsible for approximately twenty percent (20%) of the costs related to the investigation. To date, approximately $300,000 has been spent on environmental assessment work at this site. Until RIDEM provides its final response to the investigation, and the Company knows its ultimate responsibility respective to other potentially responsible parties with respect to the site, the Company cannot offer any conclusions as to its ultimate financial responsibility with respect to the site.

Fall River Gas Company was a defendant in a civil action seeking to recover anticipated remediation costs associated with contamination found at property owned by the plaintiffs (the *Cory Lane Site*) in Tiverton, Rhode Island. This claim was based on alleged dumping of material by Fall River Gas Company trucks at the site in the 1930s and 1940s. In a settlement agreement effective December 3, 2001, the Company agreed to perform all assessment, remediation and monitoring activities at the Cory Lane Site sufficient to obtain a final letter of compliance from the RIDEM.

In a letter dated March 17, 2003, RIDEM sent the New England Gas Company division of Southern Union (*NEGC*) a letter of responsibility pertaining to alleged historical MGP impacted soils in a residential neighborhood along Bay Street, Judson Street, Canonicus Street, Hooper Street, Hilton Street, Chase Street and Foote Street (collectively the Bay Street Area) in Tiverton, Rhode Island. The letter requested that NEGC prepare a draft Site Investigation Work Plan (*Work Plan*) for submittal to RIDEM by April 10, 2003, and subsequently perform a Site Investigation of the Bay Street Area. Without admitting responsibility or accepting liability, NEGC responded to RIDEM in a letter dated March 19, 2003, and agreed to perform the activities requested by the State within the period specified by RIDEM. After receiving approval from RIDEM on a Work Plan and upon obtaining access agreements from a number of property owners, NEGC began assessment work on June 2, 2003. On August 20, 2003, two former residents of the area filed a tort action against NEGC alleging personal injury to the plaintiffs. This litigation has not been served on the Company. An assessment report was filed with RIDEM on October 31, 2003, and RIDEM provided NEGC comments to the assessment report in a letter dated January 27, 2004. The January 27, 2004 RIDEM letter included the comment that additional assessment work was necessary in the Bay Street Area. On April 13, 2004, NEGC submitted Supplemental Site Investigation Work Plans for 11 properties located within the Bay Street Suspected Fill Area. These work plans were prepared in consultation with area residents by an environmental consulting firm, Woodard & Curran. Representatives of Woodard & Curran, working on behalf of the residents of the Bay Street Area, continue to meet with area residents to develop additional work plans for submission to RIDEM. NEGC has agreed to pay for Woodard & Curran's services to the community. As the Bay Street Area is built on a historic dumpsite, research is

underway to identify other potentially responsible parties associated with the area.

Valley Gas Company is a party to an action in which Blackstone Valley Electric Company (*Blackstone*) brought suit for contribution to its expenses of cleanup of a site on Mendon Road in Attleboro, Massachusetts, to which coal manufacturing waste was transported from a former MGP site in Pawtucket, Rhode Island (the *Blackstone Litigation*). Blackstone Valley Electric Company v. Stone & Webster, Inc., Stone & Webster Engineering Corporation, Stone & Webster Management Consultants, Inc. and Valley Gas Company, C. A. No. 94-10178JLT, United States District Court, District of Massachusetts. Valley Gas Company takes the position in that litigation that it is indemnified for any cleanup expenses by Blackstone pursuant to a 1961 agreement signed at the time of Valley Gas Company's creation. This suit was stayed in 1995 pending the issuance of rulemaking at the United States Environmental Protection Agency (*EPA*) (Commonwealth of Massachusetts v. Blackstone Valley Electric Company, 67 F.3d 981 (1995)). The requested rulemaking concerned the question of whether or not ferric ferrocyanide (*FFC*) is among the "cyanides" listed as toxic substances under the Clean Water Act and, therefore, is a "hazardous substance" under the Comprehensive Environmental Response, Compensation and Liability Act. On October 6, 2003, the EPA issued a Final Administrative Determination declaring that FFC is one of the "cyanides" under the environmental statutes. While the Blackstone Litigation was stayed, Valley Gas Company and Blackstone (merged with Narragansett Electric Company in May 2000) have received letters of responsibility from the RIDEM with respect to releases from two MGP sites in Rhode Island. RIDEM issued letters of responsibility to Valley Gas Company and Blackstone in September 1995 for the Tidewater MGP in Pawtucket, Rhode Island, and in February 1997 for the Hamlet Avenue MGP in Woonsocket, Rhode Island. Valley Gas Company entered into an agreement with Blackstone (now *Narragansett*) in which Valley Gas Company and Blackstone agreed to share equally the expenses for the costs associated with the Tidewater site subject to reallocation upon final determination of the legal issues that exist between the companies with respect to responsibility for expenses for the Tidewater site and otherwise. No such agreement has been reached with respect to the Hamlet site.

While the Blackstone Litigation has been stayed, National Grid and the Company have jointly pursued claims against the bankrupt Stone & Webster entities (*Stone & Webster*) based upon Stone & Webster's historic management of MGP facilities on behalf of the alleged predecessors of both companies. On January 9, 2004, the U.S. Bankruptcy Court for the District of Delaware issued an order approving a settlement between National Grid, Southern Union and Stone & Webster that provided for the payment of $5 million out of the bankruptcy estates. This payment is payable $1.25 million to Southern Union for payment of environmental costs associated with the former Fall River Gas Company, and $3.75 million payable to Southern Union and National Grid jointly for payment of future environmental costs at the Tidewater and Hamlet sites. The settlement further provides an admission of liability by Stone & Webster that gives National Grid and Southern Union additional rights against historic Stone & Webster insurers.

In a letter dated March 11, 2003, the Commonwealth of Massachusetts Department of Environmental Protection provided New England Gas Company a Notice of Responsibility for 60 and 82 Hartwell Street in Fall River, Massachusetts. This Notice of Responsibility requested that site assessment activities be conducted with respect to the listed properties and with respect to the adjacent former MGP property owned by NEGC at 66 5th Street, Fall River.

In 2003, NEGC conducted a Phase I environmental site assessment at a former MGP site in North Attleboro, Massachusetts (the Mr. Hope Street Site) to determine if the property could be redeveloped as a service center. During the site walk, coal tar was found in the adjacent creek bed, and notice to the Massachusetts Department of Environmental Protection (*MADEP*) was made. On September 18, 2003, a Phase I Initial Site Investigation Report and Tier Classification were submitted to MADEP. On November 25, 2003, MADEP issued a Notice of Responsibility letter to NEGC. Based upon the Phase I filing, NEGC is required to file a Phase II report with MADEP by September 18, 2005 to complete the site characterization.

Pennsylvania Sites. During 2002, PG Energy received inquiries from the Pennsylvania Department of Environmental Protection (*PADEP*) pertaining to three Pennsylvania former MGP sites located in Scranton, Bloomsburg, and Carbondale. At the request of PADEP, PG Energy is currently performing environmental assessment work at the Scranton MGP site. On March 23, 2004, PG Energy filed an Initial Site Assessment Characterization report on the Scranton site. PG Energy has participated financially in PPL Electric Utilities Corporation's (*PPL's*) environmental and health assessment of an additional MGP site located in Sunbury, Pennsylvania. In May 2003, PPL commenced a remediation project at the Sunbury site that was completed in August 2003. PG Energy has contributed to PPL's

remediation project by removing and relocating gas utility lines located in the path of the remediation. In a letter dated January 12, 2004, PADEP notified PPL of its approval of the Remedy Certification Report submitted by PPL for the Sunbury MGP clean-up project.

On March 31, 2004, PG Energy entered into a voluntary Consent Order and Agreement (*Multi-Site Agreement*) with the PADEP. This Multi-Site Agreement is for the purpose of developing and implementing an environmental assessment and remediation program for five MGP sites (including the Scranton, Bloomsburg and Carbondale sites) and six MGP holder sites owned by PG Energy in the State of Pennsylvania. Under the Multi-Site Agreement, PG Energy is to perform environmental assessments of these sites within two years of the effective date of the Multi-Site Agreement. Thereafter, PG Energy is required to perform additional assessment and remediation activity as is deemed to be necessary based upon the results of the initial assessments. The Company does not believe the outcome of these matters will have a material adverse effect on its financial position, results of operations or cash flows.

To the extent that potential costs associated with former MGPs are quantified, the Company expects to provide any appropriate accruals and seek recovery for such remediation costs through all appropriate means, including in rates charged to gas distribution customers, insurance and regulatory relief. At the time of the closing of the acquisition of the Company's Missouri service territories, the Company entered into an Environmental Liability Agreement that provides that Western Resources retains financial responsibility for certain liabilities under environmental laws that may exist or arise with respect to Missouri Gas Energy. In addition, the New England Division has reached agreement with its Rhode Island rate regulators on a regulatory plan that creates a mechanism for the recovery of environmental costs over a ten-year period. This plan, effective July 1, 2002, establishes an environmental fund for the recovery of evaluation, remedial and clean-up costs arising out of the Company's MGPs and sites associated with the operation and disposal activities from MGPs. Similarly, environmental costs associated with Massachusetts' facilities are recoverable in rates over a seven-year period.

Panhandle Energy Environmental Matters – Panhandle Energy's interstate natural gas transportation operations are subject to federal, state and local regulations regarding water quality, hazardous and solid waste disposal and other environmental matters. Panhandle Energy has identified environmental contamination at certain sites on its gas transmission systems and has undertaken clean-up programs at these sites. The contamination resulted from the past use of lubricants containing polychlorinated bi-phenyls (*PCBs*) in compressed air systems; the past use of paints containing PCBs; and the past use of wastewater collection facilities and other on-site disposal areas. Panhandle Energy has developed and is implementing a program to remediate such contamination in accordance with federal, state and local regulations. Some remediation is being performed by former Panhandle Energy affiliates in accordance with indemnity agreements that also indemnify against certain future environmental litigation and claims.

As part of the clean-up program resulting from contamination due to the use of lubricants containing PCBs in compressed air systems, Panhandle Eastern Pipe Line and Trunkline Gas Company have identified PCB levels above acceptable levels inside the auxiliary buildings that house air compressor equipment at thirty-three compressor station sites. Panhandle Energy has developed and is implementing an EPA-approved process to remediate this PCB contamination in accordance with federal, state and local regulations. Three sites have been decontaminated per the EPA process as prescribed in the EPA regulations.

At some locations, PCBs have been identified in paint that was applied many years ago. In accordance with EPA regulations, Panhandle Energy has implemented a program to remediate sites where such issues are identified during painting activities. If PCBs are identified above acceptable levels, the paint is removed and disposed of in an EPA-approved manner.

The Illinois Environmental Protection Agency (*Illinois EPA*) notified Panhandle Eastern Pipe Line and Trunkline, together with other non-affiliated parties, of contamination at three former waste oil disposal sites in Illinois. Panhandle Eastern Pipe Line's and Trunkline's estimated share for the costs of assessment and remediation of the sites, based on the volume of waste sent to the facilities, is approximately 17 percent. Panhandle Energy and 21 other non-affiliated parties conducted an initial voluntary investigation of the Pierce Oil Springfield site, one of the three sites. Based on the information found during the initial investigation, Panhandle Energy and the 21 other non-affiliated parties have decided to further delineate the extent of contamination by authorizing a Phase II investigation at this site. Once data from the Phase II investigation is evaluated, Panhandle Energy and the 21 other non-affiliated parties will

determine what additional actions will be taken. In addition, Illinois EPA has informally indicated that it has referred the Pierce Oil Springfield site, to the EPA so that environmental contamination present at the site can be addressed through the federal Superfund program. No formal notice has yet been received from either agency concerning the referral. However, the EPA is expected to issue special notice letters in 2004 and has begun the process of listing the site on the National Priority List. Panhandle Energy and three of the other non-affiliated parties associated with the Pierce Oil Springfield site met with the U.S. EPA and Illinois EPA regarding this issue. Panhandle Energy was given no indication as to when the listing process was to be completed.

Based on information available at this time, it would appear the amount reserved for all of the above is adequate to cover the potential exposure for clean-up costs.

Air Quality Control

In 1998, the EPA issued a final rule on regional ozone control that requires Panhandle Energy to place controls on engines in five midwestern states. The part of the rule that affects Panhandle Energy was challenged in court by various states, industry and other interests, including Interstate Natural Gas Association of America (*INGAA*), an industry group to which Panhandle Energy belongs. In March 2000, the court upheld most aspects of the EPA's rule, but agreed with INGAA's position and remanded to the EPA the sections of the rule that affected Panhandle Energy. The final rule is expected in 2004. Based on an EPA guidance document negotiated with gas industry representatives in 2002, it is believed that Panhandle Energy will be required to reduce nitrogen oxide (*NOx*) emissions by 82% on the identified large internal combustion engines and will be able to trade off engines within the company and within each of the five Midwestern states affected by the rule in an effort to create a cost effective NOx reduction solution. The implementation date is expected to be May 2007. The rule impacts 20 large internal combustion engines on the Panhandle Energy system in Illinois and Indiana at an approximate cost of $17 million for capital improvements through 2007, based on current projections.

In 2002, the Texas Commission on Environmental Quality enacted the Houston/Galveston SIP regulations requiring reductions in NOx emissions in an eight-county area surrounding Houston. Trunkline's Cypress compressor station is affected and may require the installation of emission controls. New regulations also require certain grandfathered facilities in Texas to enter into the new source permit program which may require the installation of emission controls at five additional facilities. These two rules affect six company facilities in Texas at an estimated cost of approximately $12 million for capital improvements through December 2007, based on current projections.

The EPA promulgated various Maximum Achievable Control Technology (*MACT*) rules in August 2003 and February 2004. The rules require that Panhandle Eastern Pipe Line and Trunkline control Hazardous Air Pollutants (*HAPs*) emitted from certain internal combustion engines at major HAPs sources. Most of Panhandle Eastern Pipe Line and Trunkline compressor stations are major HAPs sources. The HAPs pollutant of concern for Panhandle Eastern Pipe Line and Trunkline is formaldehyde. As promulgated, the rule seeks to reduce formaldehyde emissions by 76% from these engines. Catalytic controls will be required to reduce emissions under these rules with a final implementation date of May 2007. Panhandle Eastern Pipe Line and Trunkline have 20 internal combustion engines subject to the rules. It is expected that compliance with these regulations will cost an estimated $5 million, based on current projections.

Regulatory

On May 31, 2002, the staff of the MPSC recommended that the Commission disallow approximately $15 million in gas costs incurred during the period July 1, 2000 through June 30, 2001. Missouri Gas Energy filed its response in opposition to the Staff's recommendation on July 11, 2002, vigorously disputing the Commission staff's assertions. Missouri Gas Energy intends to vigorously defend itself in this proceeding. This matter went into recess following a hearing in May of 2003. Following the May hearing, the Commission staff reduced its disallowance recommendation to approximately $9.3 million. The hearing concluded in November 2003 and the matter was fully submitted to the Commission in February 2004 and is awaiting decision by the Commission.

On November 27, 2001, August 1, 2000 and August 12, 1999, the staff of the MPSC recommended that the Commission disallow approximately $5.9 million, $5.9 million and $4.3 million, respectively, in gas costs incurred during the period July 1, 1999 through June 30, 2000, July 1, 1998 through June 30, 1999, and July 1, 1997 through

June 30, 1998, respectively. The basis of these proposed disallowances appears to be the same as was rejected by the Commission through an order dated March 12, 2002, applicable to the period July 1, 1996 through June 30, 1997. MGE intends to vigorously defend itself in these proceedings. On November 4, 2002, the Commission adopted a procedural schedule calling for a hearing in this matter some time after May 2003. No date for this hearing has been set.

Southwest Gas Litigation

Several actions were commenced in federal courts by persons involved in competing efforts to acquire Southwest Gas Corporation (*Southwest*) during 1999. All of these actions eventually were transferred to the District of Arizona (the *Court*), consolidated and lodged with Judge Roslyn Silver. As a result of summary judgments granted, there were no claims allowed against Southern Union. Southern Union's claims against Southwest were settled on August 6, 2002, by Southwest's payment to Southern Union of $17,500,000. Southern Union's claims against ONEOK and the individual defendants associated with ONEOK were settled on January 3, 2003, following the closing of Southern Union's sale of the Texas assets to ONEOK, by ONEOK's payment to Southern Union of $5,000,000. Southern Union's claims against Jack Rose, former aide to former Arizona Corporation Commissioner James Irvin, were settled by Mr. Rose's payment to Southern Union of $75,000, which the Company donated to charity. The trial of Southern Union's claims against the sole-remaining defendant, former Arizona Corporation Commissioner James Irvin, was concluded on December 18, 2002, with a jury award to Southern Union of nearly $400,000 in actual damages and $60,000,000 in punitive damages against former Commissioner Irvin. The Court denied former Commissioner Irvin's motions to set aside the verdict and reduce the amount of punitive damages. Former Commissioner Irvin has appealed to the Ninth Circuit Court of Appeals. A decision on the appeal by the Ninth Circuit is expected by the first calendar quarter of 2005. The Company intends to vigorously pursue collection of the award. With the exception of ongoing legal fees associated with the collection of damages from former Commissioner Irvin, the Company believes that the results of the above-noted Southwest litigation and any related appeals will not have a materially adverse effect on the Company's financial condition, results of operations or cash flows.

Southern Union and its subsidiaries are parties to other legal proceedings that management considers to be normal actions to which an enterprise of its size and nature might be subject. Management does not consider these actions to be material to Southern Union's overall business or financial condition, results of operations or cash flows.

Other

In 1993, the U.S. Department of the Interior announced its intention to seek, through its Minerals Management Service (*MMS*) additional royalties from gas producers as a result of payments received by such producers in connection with past take-or-pay settlements, buyouts or buy downs of gas sales contracts with natural gas pipelines. Panhandle Energy's pipelines, with respect to certain producer contract settlements, may be contractually required to reimburse or, in some instances, to indemnify producers against such royalty claims. The potential liability of the producers to the government and of the pipelines to the producers involves complex issues of law and fact which are likely to take substantial time to resolve. If required to reimburse or indemnify the producers, Panhandle Energy's pipelines may file with the FERC to recover a portion of these costs from pipeline customers. Panhandle Energy does not believe the outcome of this matter will have a material adverse effect on its financial position, results of operations or cash flows.

Following its acquisition by the Company in June 2003, Panhandle Energy initiated a workforce reduction initiative designed to reduce the workforce by approximately 5 percent. The workforce reduction initiative was an involuntary plan with a voluntary component, and was fully implemented by September 30, 2003. Total estimated workforce reduction initiative costs are approximately $9,000,000 which are a portion of the $30,448,000 of additional transaction costs incurred (see *Acquisition and Sales*).

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DISCONTINUED OPERATIONS

Effective January 1, 2003, the Company completed the sale of its Southern Union Gas natural gas operating division and related assets to ONEOK, Inc. (*ONEOK*) for approximately $437,000,000 in cash resulting in a pre-tax gain of $62,992,000. In accordance with accounting principles generally accepted in the United States of America, the results of operations and gain on sale of the Texas operations have been segregated and reported as "discontinued operations" in the Consolidated Statement of Operations and as "assets held for sale" in the Consolidated Statement of Cash Flows for the respective periods.

The following table summarizes the Texas operations' results of operations that have been segregated and reported as "discontinued operations" in the Company's Consolidated Statement of Operations:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2004	2003	2004	2003
Operating revenues	$ –	$ –	$ –	$ 144,490
Net operating margin (a)	$ –	$ –	$ –	$ 51,480
Net earnings from discontinued operations (b)	$ –	$ 17,665	$ –	$ 31,256

(a) Net operating margin consists of operating revenues less gas purchase costs and revenue-related taxes.
(b) Net earnings from discontinued operations do not include any allocation of interest expense or other corporate costs, in accordance with generally accepted accounting principles. At the time of the sale, all outstanding debt of Southern Union Company and subsidiaries was maintained at the corporate level, and no debt was assumed by ONEOK, Inc. in the sale of the Texas operations.

REPORTABLE SEGMENTS

The Company's operations include two reportable segments: (i) Transportation and Storage, and (ii) Distribution. The Transportation and Storage segment is primarily engaged in the interstate transportation and storage of natural gas in the Midwest and Southwest, and also provides LNG terminalling and regasification services. Its operations are conducted through Panhandle Energy, which the Company acquired on June 11, 2003. The Distribution segment is primarily engaged in the local distribution of natural gas in Missouri, Pennsylvania, Rhode Island and Massachusetts. Its operations are conducted through the Company's three regulated utility divisions: Missouri Gas Energy, PG Energy and New England Gas Company.

Revenue included in the All Other category is attributable to several operating subsidiaries of the Company: PEI Power Corporation generates and sells electricity; PG Energy Services Inc. offers appliance service contracts; ProvEnergy Power Company LLC (*ProvEnergy Power*), which the Company sold effective October 31, 2003, provided outsourced energy management services and owned 50% of Capital Center Energy Company LLC, a joint venture formed between ProvEnergy and ERI Services, Inc. to provide retail power and conditioned air; and Alternate Energy Corporation provides energy consulting services. None of these businesses have ever met the quantitative thresholds for determining reportable segments individually or in the aggregate. The Company also has corporate operations that do not generate any revenues.

The Company evaluates segment performance based on several factors, of which the primary financial measure is net operating revenues. Net Operating Revenues is defined as operating margin, less operating, maintenance and general expenses, depreciation and amortization, and taxes other than on income and revenues.

The following table sets forth certain selected financial information for the Company's segments for the three- and nine-month periods ended March 31, 2004 and 2003. Financial information for the Transportation and Storage segment reflects the operations of Panhandle Energy beginning on its acquisition date of June 11, 2003. There were no material intersegment revenues during the periods presented.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Three Months Ended March 31,		Nine Months Ended March 31	
	2004	2003	2004	2003
Revenues from external customers:				
Distribution	$ 635,384	$ 534,573	$ 1,127,235	$ 978,078
Transportation and Storage	138,179	–	382,742	–
All Other	1,016	1,090	3,109	3,399
Total consolidated operating revenues	$ 774,579	$ 535,663	$ 1,513,086	$ 981,477
Operating Margin:				
Distribution	$ 158,846	$ 160,506	$ 322,134	$ 331,078
Transportation and Storage	138,179	–	382,742	–
All Other	867	894	2,422	2,817
Total consolidated operating margin	$ 297,892	$ 161,400	$ 707,298	333,895
Depreciation and amortization:				
Distribution	$ 14,192	$ 14,361	$ 43,455	$ 42,466
Transportation and Storage (1)	11,954	–	45,112	–
All Other	141	141	430	428
Total segment depreciation and amortization	26,287	14,502	88,997	42,894
Reconciling item – Corporate	132	119	453	178
Total consolidated depreciation and amortization	$ 26,419	$ 14,621	$ 89,450	$ 43,072
Net operating revenues (loss):				
Distribution	$ 83,620	$ 95,578	$ 116,536	$ 148,069
Transportation and Storage	68,974	–	159,495	–
All Other	(2,716)	(30)	(3,453)	(335)
Total segment net operating revenues	149,878	95,548	272,578	147,734
Reconciling item – Corporate	487	(3,406)	(2,857)	(7,879)
Total consolidated net operating revenues	$ 150,365	$ 92,142	$ 269,721	$ 139,855
Expenditures for long-lived assets:				
Distribution	$ 13,257	$ 8,458	$ 55,049	$ 43,000
Transportation and Storage	25,346	–	88,701	–
All Other	768	(113)	1,056	991
Total segment expenditures for long-lived assets	39,371	8,345	144,806	43,991
Reconciling item – Corporate	3,960	3,167	9,616	5,627
Total consolidated expenditures for long-lived assets	$ 43,331	$ 11,512	$ 154,422	$ 49,618
Reconciliation of net operating revenues to earnings from continuing operations before income taxes:				
Net operating revenues	$ 150,365	$ 92,142	$ 269,721	$ 139,855
Interest	(31,055)	(19,840)	(97,655)	(61,583)
Dividends on preferred securities of subsidiary trust	–	(2,370)	–	(7,110)
Other income, net	1,451	5,223	5,772	18,949
Earnings from continuing operations before income taxes	$ 120,761	$ 75,155	$ 177,838	$ 90,111

	March 31, 2004	June 30, 2003
Total assets:		
Distribution	$ 2,300,332	$ 2,243,257
Transportation and Storage	2,216,746	2,212,467
All Other	42,427	50,073
Total segment assets	4,559,505	4,505,797
Reconciling item – Corporate	114,490	91,928
Total consolidated assets	$ 4,673,995	$ 4,597,725

(1) Depreciation and amortization reflected herein for the three-month period ended March 31, 2004 is $3,193,000 less than that reported by Panhandle Energy in its separate SEC filing for the same period. The outside appraisals for the Panhandle Energy assets acquired and liabilities assumed were finalized after Southern Union had filed their second quarter Form 10-Q but prior to Panhandle Energy filing its December 31, 2003 Form 10-K. Panhandle Energy was able to reflect depreciation and amortization expense consistent with the final outside appraisals as of December 31, 2003, which Southern Union recognized during the three-month period ended March 31, 2004.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview. Southern Union Company (*Southern Union* and together with its subsidiaries, the *Company*) is primarily engaged in the transportation, storage and distribution of natural gas in the United States. The Company's interstate natural gas transportation and storage operations are conducted through Panhandle Energy, which serves approximately 500 customers in the Midwest and Southwest. Panhandle Energy was acquired by Southern Union on June 11, 2003, as further described below. The Company's local natural gas distribution operations are conducted through its three regulated utility divisions, Missouri Gas Energy, PG Energy and New England Gas Company, which collectively serve over 950,000 residential, commercial and industrial customers in Missouri, Pennsylvania, Rhode Island and Massachusetts.

On June 11, 2003, Southern Union acquired Panhandle Energy from CMS Energy Corporation for approximately $581,729,000 in cash and 3,000,000 shares of Southern Union common stock (before adjustment for subsequent stock dividends) valued at approximately $48,900,000 based on market prices at closing of the Panhandle Energy acquisition and in connection therewith incurred transaction costs of approximately $30,448,000. Southern Union also incurred additional deferred state income tax liabilities estimated at $10,597,000 as a result of the transaction. At the time of the acquisition, Panhandle Energy had approximately $1,157,228,000 of debt principal outstanding that it retained. The Company funded the cash portion of the acquisition with approximately $437,000,000 in cash proceeds it received for the January 1, 2003 sale of its Texas operations, approximately $121,250,000 of the net proceeds it received from concurrent common stock and equity unit offerings and with working capital available to the Company. The Company structured the Panhandle Energy acquisition and the sale of its Texas operations to qualify as a like-kind exchange of property under Section 1031 of the Internal Revenue Code of 1986, as amended. The acquisition was accounted for using the purchase method of accounting in accordance with accounting principles generally accepted in the United States of America by allocating the purchase price and acquisition costs incurred by the Company to Panhandle Energy's net assets as of the acquisition date. The Panhandle Energy assets acquired and liabilities assumed have been recorded at their estimated fair value as of the acquisition date based on the results of outside appraisals. Items which are still under review are the valuation of certain contingent liabilities as of the acquisition date. Panhandle Energy's results of operations have been included in the Consolidated Statement of Operations since June 11, 2003. Thus, the Consolidated Statement of Operations for the periods subsequent to the acquisition is not comparable to the same periods in prior years.

Panhandle Energy is primarily engaged in the interstate transportation and storage of natural gas and also provides liquefied natural gas (*LNG*) terminalling and regasification services and is subject to the rules and regulations of the Federal Energy Regulatory Commission (*FERC*). The Panhandle Energy entities include Panhandle Eastern Pipe Line Company, LLC (*Panhandle Eastern Pipe Line*), Trunkline Gas Company, LLC (*Trunkline*) a wholly-owned subsidiary of Panhandle Eastern Pipe Line, Sea Robin Pipeline Company (*Sea Robin*), a Louisiana unincorporated joint venture and an indirect wholly-owned subsidiary of Panhandle Eastern Pipe Line, Trunkline LNG Company, LLC (*Trunkline LNG*) which is a wholly-owned subsidiary of Trunkline LNG Holdings, LLC (*LNG Holdings*) an indirect wholly-owned subsidiary of Panhandle Eastern Pipe Line and Pan Gas Storage, LLC (d.b.a. *Southwest Gas Storage*), a wholly-owned subsidiary of Panhandle Eastern Pipe Line. Collectively, the pipeline assets include more than 10,000 miles of interstate pipelines that transport natural gas from the Gulf of Mexico, South Texas and the Panhandle regions of Texas and Oklahoma to major U.S. markets in the Midwest and Great Lakes region. The pipelines have a combined peak day delivery capacity of 5.4 billion cubic feet (*Bcf*) per day and 72 Bcf of owned underground storage capacity. Trunkline LNG, located on Louisiana's Gulf Coast, operates one of the largest LNG import terminals in North America and has 6.3 Bcf of above ground LNG storage capacity.

Upon acquiring Panhandle Energy it was determined that Panhandle Energy's operations could not be integrated efficiently into Southern Union, but that a new operating platform would have to be established. By doing this at Panhandle Energy, the Company obviated the need for any corporate information technology allocation and, established a more efficient platform from which to operate all of the Company's businesses. Direct integration savings of $15,000,000 were expected from this process of which, substantially, the entire amount has been achieved to date.

Effective January 1, 2003, the Company completed the sale of its Southern Union Gas natural gas operating division and related assets to ONEOK, Inc. (*ONEOK*) for approximately $437,000,000 in cash resulting in a pre-tax gain of $62,992,000. In accordance with accounting principles generally accepted in the United States of America, the results of operations and gain on sale of the Texas operations have been segregated and reported as "discontinued

operations" in the Consolidated Statement of Operations and as "assets held for sale" in the Consolidated Statement of Cash Flows for the respective periods.

RESULTS OF OPERATIONS

The Company's results of operations are discussed on a consolidated basis and on a segment basis for each of the two reportable segments. The Company's reportable segments include the Transportation and Storage segment and the Distribution segment. Segment results of operations are presented on a net operating revenues basis. Net operating revenues is defined as operating margin, less operating, maintenance and general expenses, depreciation and amortization, and taxes other than on income and revenues, and represents one of the financial measures that the Company uses to internally manage its business. For additional segment reporting information, see *Reportable Segments* in Notes to Consolidated Financial Statements.

Consolidated Results

The following table provides selected financial information regarding the Company's consolidated results of operations for the three- and nine-month periods ended March 31, 2004 and 2003:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2004	2003	2004	2003
	(*thousands of dollars*)			
Net operating revenues (loss):				
Distribution segment	$ 83,620	$ 95,578	$ 116,536	$ 148,069
Transportation and storage segment	68,974	–	159,495	–
All other	(2,716)	(30)	(3,453)	(335)
Corporate	487	(3,406)	(2,857)	(7,879)
Total net operating revenues	150,365	92,142	269,721	139,855
Other income (expenses):				
Interest	(31,055)	(19,840)	(97,655)	(61,583)
Dividends on preferred securities of subsidiary trust	–	(2,370)	–	(7,110)
Other, net	1,451	5,223	5,772	18,949
Total other expenses, net	(29,604)	(16,987)	(91,883)	(49,744)
Federal and state income taxes	45,394	28,921	67,756	34,544
Net earnings from continuing operations	75,367	46,234	110,082	55,567
Discontinued operations:				
Earnings from discontinued operations before income taxes	–	62,992	–	84,773
Federal and state income taxes	–	45,327	–	53,517
Net earnings from discontinued operations	–	17,665	–	31,256
Net earnings	75,367	63,899	110,082	86,823
Preferred stock dividends	(4,341)	–	(8,345)	–
Net earnings available for common shareholders	$ 71,026	$ 63,899	$ 101,737	$ 86,823

SOUTHERN UNION COMPANY AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Three Months Ended March 31, 2004 Compared to 2003. The Company recorded net earnings available for common shareholders from continuing operations (hereafter referred to as "net earnings from continuing operations") of $71,026,000 for the three-month period ended March 31, 2004 compared with net earnings from continuing operations of $46,234,000 for the same period in 2003. Net earnings from continuing operations per diluted share were $.96 in 2004 compared with $.79 in 2003. The Company recorded net earnings available for common shareholders of $71,026,000 for the three-month period ended March 31, 2004 compared with net earnings of $63,899,000 for the same period in 2003. Net earnings available for common shareholders per diluted share were $.96 in 2004 compared with $1.09 in 2003.

The $24,792,000 increase in net earnings from continuing operations was primarily attributable to an increase in net operating revenues from the Transportation and Storage segment of $68,974,000, a decrease in net operating loss from Corporate operations of $3,893,000, and a decrease in dividends on preferred securities of subsidiary trust of $2,370,000, which were partially offset by a decrease in net operating revenues from the Distribution segment of $11,958,000, an increase in net operating loss from All Other operations of $2,686,000, an increase in interest expense of $11,215,000, a decrease in other income of $3,772,000, an increase in income taxes of $16,473,000, and an increase in preferred stock dividends of $4,341,000 (see *Business Segment Results, All Other Operations, Corporate, Interest Expense, Dividends on Preferred Securities of Subsidiary Trust, Other Income (Expense), Net, Federal and State Income Taxes,* and *Preferred Stock Dividends,* below).

Net earnings from discontinued operations were nil for the three-month period ended March 31, 2004 compared with $17,665,000 for the same period in 2003. Net earnings from discontinued operations per diluted share were nil in 2004 compared with $.30 in 2003.

Nine Months Ended March 31, 2004 Compared to 2003. The Company recorded net earnings from continuing operations of $101,737,000 for the nine-month period ended March 31, 2004 compared with net earnings from continuing operations of $55,567,000 for the same period in 2003. Net earnings from continuing operations per diluted share were $1.38 in 2004 compared with $.95 in 2003. The Company recorded net earnings available for common shareholders of $101,737,000 for the nine-month period ended March 31, 2004 compared with net earnings of $86,823,000 for the same period in 2003. Net earnings available for common shareholders per diluted share were $1.38 in 2004 compared with $1.48 in 2003.

The $46,170,000 increase in net earnings from continuing operations was primarily attributable to an increase in net operating revenues from the Transportation and Storage segment of $159,495,000, a decrease in net operating loss from Corporate operations of $5,022,000, and a decrease in dividends on preferred securities of subsidiary trust of $7,110,000, which were partially offset by a decrease in net operating revenues from the Distribution segment of $31,533,000, an increase in net operating loss from All Other operations of $3,118,000, an increase in interest expense of $36,072,000, a decrease in other income of $13,177,000, an increase in income taxes of $33,212,000 and an increase in preferred stock dividends of $8,345,000 (see *Business Segment Results, All Other Operations, Corporate, Interest Expense, Dividends on Preferred Securities of Subsidiary Trust, Other Income (Expense), Net, Federal and State Income Taxes,* and *Preferred Stock Dividends,* below).

Net earnings from discontinued operations were nil for the nine-month period ended March 31, 2004 compared with $31,256,000 for the same period in 2003. Net earnings from discontinued operations per diluted share were nil in 2004 compared with $.53 in 2003.

All Other Operations. Net operating loss from subsidiary operations included in the All Other category was $2,716,000 for the three-month period ended March 31, 2004, compared with $30,000 in 2003. Net operating loss from subsidiary operations for the three-month period ended March 31, 2004 includes a $2,985,000 charge recorded by PEI Power Corporation in March 2004 to reserve for the estimated debt service payments in excess of projected tax revenues for the tax incremental financing obtained for the development of PEI Power Park.

Net operating loss from subsidiary operations included in the All Other category was $3,453,000 for the nine-month period ended March 31, 2004, compared with $335,000 in 2003. Net operating loss from subsidiary operations for the nine-month period ended March 31, 2004 includes the $2,985,000 charge by PEI Power, as previously discussed.

Corporate. Net operating revenues from Corporate operations were $487,000 for the three-month period ended March 31, 2004, compared with a net operating loss of $3,406,000 in 2003. Net operating revenues between periods was primarily impacted by the direct allocation and recording of various services provided by Corporate to Panhandle Energy in 2004, that were not applicable in 2003 due to the timing of the Panhandle Energy acquisition.

Net operating loss from Corporate operations was $2,857,000 for the nine-month period ended March 31, 2004, compared with $7,879,000 in 2003. Net operating revenues were primarily impacted by the allocation of Corporate costs to Panhandle Energy, as previously discussed.

Interest Expense. Interest expense was $31,055,000 for the three-month period ended March 31, 2004, compared with $19,840,000 in 2003. Interest expense for the three-month period ended March 31, 2004 was impacted by interest expense on debt related to Panhandle Energy of $12,155,000 (net of amortization of debt premiums established in purchase accounting related to the Panhandle Energy acquisition). This increase was partially offset by decreased interest expense of $997,000 on the $311,087,000 bank note (the *2002 Term Note*) entered into by the Company on July 15, 2002 to refinance a portion of the $485 million Term Note entered into by the Company on August 28, 2000 to (i) fund the cash consideration paid to stockholders of Fall River Gas, ProvEnergy and Valley Resources, (ii) refinance and repay long- and short-term debt assumed in the New England Operations, and (iii) acquisition costs of the New England Operations. This decrease in the 2002 Term Note interest was due to reductions in LIBOR rates during fiscal 2004 and the principal repayment of $175,000,000 of the 2002 Term Note since its inception. The average rate of interest on all debt decreased from 5.9% in 2003 to 5.1% in 2004.

Interest expense was $97,655,000 for the nine-month period ended March 31, 2004, compared with $61,583,000 in 2003. Interest expense for the nine-month period ended March 31, 2004 was impacted by interest expense on debt related to Panhandle Energy of $35,604,000 (net of amortization of debt premiums established in purchase accounting related to the Panhandle Energy acquisition) and by $3,160,000 related to dividends on preferred securities of subsidiary trust (see *Dividends on Preferred Securities of Subsidiary Trust.*) These items were partially offset by a decrease in interest expense of $3,409,000 in 2004 on the aforementioned 2002 Term Note. The average rate of interest on all debt decreased from 6.0% in 2003 to 5.1% in 2004.

Dividends on Preferred Securities of Subsidiary Trust. Dividends on preferred securities of subsidiary trust were nil and $2,370,000 for the three-month periods ended March 31, 2004 and 2003, respectively, and nil and $7,110,000 for the nine-month periods ended March 31, 2004 and 2003, respectively.

Effective July 1, 2003, the Company adopted the FASB standard, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,* which requires dividends on preferred securities of subsidiary trusts to be classified as interest expense; the reclassification of amounts reported as dividends in prior periods is not permitted. In accordance with the Statement, $3,160,000 of dividends on preferred securities of subsidiary trust recorded by the Company subsequent to July 1, 2003, have been classified as interest expense (see *Interest Expense*). On October 1, 2003, the Company called the Subordinated Notes for redemption, and the Subordinated Notes and Preferred Securities were redeemed on October 31, 2003.

Other Income (Expense), Net. Other income for the three-month period ended March 31, 2004 was $1,451,000 compared with $5,223,000 for the same period in 2003. Other income for the three-month period ended March 31, 2004 includes income of $413,000 generated from the sale and/or rental of gas-fired equipment and appliances and several other items, none of which are individually significant. Other income for the three-month period ended March 31, 2003 includes a gain of $5,000,000 on the settlement of litigation relating to the Company's unsuccessful acquisition of Southwest Gas Corporation (*Southwest*) and income of $569,000 generated from the sale and/or rental of gas-fired equipment and appliances by various operating subsidiaries. These items were partially offset by $504,000 of legal costs related to the Southwest litigation.

Other income for the nine-month period ended March 31, 2004 was $5,772,000 compared with $18,949,000 for the same period in 2003. Other income for the nine-month period ended March 31, 2004 includes a gain of $6,354,000 on the early extinguishment of debt and income of $1,748,000 generated from the sale and/or rental of gas-fired equipment and appliances. These items were partially offset by charges of $1,603,000 and $1,150,000 to reserve for the impairment of Southern Union's investments in a technology company and in an energy-related joint venture,

respectively, and $764,000 of legal costs associated with the collection of damages from former Arizona Corporation Commissioner James Irvin related to the Southwest litigation. Other income for the nine-month period ended March 31, 2003 includes a gain of $22,500,000 on the settlement of the Southwest litigation, and income of $1,718,000 generated from the sale and/or rental of as-fired equipment and appliances by various operating subsidiaries. These items were partially offset by $5,473,000 of legal costs related to the Southwest litigation and $1,298,000 of selling costs related to the Texas operations' disposition.

Federal and State Income Taxes. Federal and state income tax expense from continuing operations for the three-month periods ended March 31, 2004 and 2003 was $45,394,000 and $28,921,000, respectively. The Company's consolidated federal and state effective income tax rate was 38% for the three-month periods ended March 31, 2004 and 2003.

Federal and state income tax expense from continuing operations for the nine-month periods ended March 31, 2004 and 2003 was $67,756,000 and $34,544,000, respectively. The Company's consolidated federal and state effective income tax rate was 38% for the nine-month periods ended March 31, 2004 and 2003.

Preferred Stock Dividends. Dividends on preferred securities were $4,341,000 and nil for the three-month periods ended March 31, 2004 and 2003, respectively, and $8,345,000 and nil for the nine-month periods ended March 31, 2004 and 2003, respectively. On October 8, 2003, the Company issued $230,000,000 of 7.55% Non-cumulative Preferred Stock, Series A to the public (see *Financial Condition,* below).

Discontinued Operations. Net earnings from discontinued operations were nil for the three- and nine-month periods ended March 31, 2004 compared with $17,665,000 and $31,256,000 for the same periods in 2003. The Company completed the sale of its Texas operations effective January 1, 2003, resulting in the recording of an after-tax gain on sale of $18,928,000 during the fiscal year ended June 30, 2003 that is reported in earnings from discontinued operations in accordance with the Financial Accounting Standards Board (*FASB*) standard, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The after-tax gain on the sale of the Texas operations was impacted by the elimination of $70,469,000 of goodwill related to these operations which was primarily non-tax deductible.

Business Segment Results

Distribution Segment -- The Company's Distribution segment is primarily engaged in the local distribution of natural gas in Missouri, Pennsylvania, Rhode Island and Massachusetts. Its operations are conducted through the Company's three regulated utility divisions: Missouri Gas Energy, PG Energy and New England Gas Company. Collectively, the utility divisions serve more than 950,000 residential, commercial and industrial customers.

The following table provides summary financial information regarding the Distribution segment's results of operations for the three- and nine-month periods ended March 31, 2004 and 2003:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2004	2003	2004	2003
	(thousands of dollars)			
Operating revenues	$ 635,384	$ 534,573	$ 1,127,235	$ 978,078
Cost of gas and other energy	(454,587)	(356,197)	(765,689)	(613,377)
Revenue-related taxes	(21,951)	(17,870)	(39,412)	(33,623)
Operating margin	158,846	160,506	322,134	331,078
Operating expenses:				
Operating, maintenance, and general	54,525	44,318	144,014	122,062
Depreciation and amortization	14,192	14,361	43,455	42,466
Taxes other than on income and revenues	6,509	6,249	18,129	18,481
Total operating expense	75,226	64,928	205,598	183,009
Net operating revenues	$ 83,620	$ 95,578	$ 116,536	$ 148,069

Operating Revenues. Operating revenues were $635,384,000 for the three-month period ended March 31, 2004, compared with $534,573,000 for the same period in 2003. Gas purchase and other energy costs for the three-month period ended March 31, 2004 were $454,587,000, compared with $356,197,000 in 2003. The Company's operating revenues are affected by the level of sales volumes and by the pass-through of increases or decreases in the Company's gas purchase costs through its purchased gas adjustment clauses. Additionally, revenues are affected by increases and decreases in gross receipts taxes (revenue-related taxes) which are levied on sales revenue as collected from customers and remitted to the various taxing authorities. The increase in both operating revenues and gas purchase costs between periods was primarily due to a 33% increase in the average cost of gas from $6.03 per thousand cubic feet (*Mcf*) in 2003 to $8.01 per Mcf in 2004, which was partially offset by a 4% decrease in gas sales volumes to 56,722 million cubic feet (*MMcf*) in 2004 from 59,095 MMcf in 2003. The increase in the average cost of gas is due to increases in the average spot market prices throughout the Company's distribution system as a result of current competitive pricing occurring within the entire energy industry. The decrease in gas sales volumes is primarily due to warmer weather in 2004 as compared with 2003 in all of the Company's service territories.

Weather in Missouri Gas Energy's service territories was 96% of a 30-year measure for the three-month period ended March 31, 2004, compared with 100% in 2003. PG Energy's service territories experienced weather that was 106% of a 30-year measure for the three-month period ended March 31, 2004, compared with 108% in 2003. Weather for the New England Gas Company service territories was 105% of a 30-year measure for the three-month period ended March 31, 2004, compared with 108% in 2003.

Operating revenues were $1,127,235,000 for the nine-month period ended March 31, 2004, compared with $978,078,000 for the same period in 2003. Gas purchase and other energy costs for the nine-month period ended March 31, 2004 were $765,689,000 compared with $613,377,000 in 2003. The increase in both operating revenues and gas purchase costs between periods was primarily due to a 32% increase in the average cost of gas from $5.86 per Mcf in 2003 to $7.73 per Mcf in 2004, which was partially offset by a 5% decrease in gas sales volumes to 99,026 MMcf in 2004 from 104,619 MMcf in 2003. The increase in the average cost of gas is due to increases in the average spot market prices throughout the Company's distribution system as a result of current competitive pricing occurring within the entire energy industry. The decrease in gas sales volumes is primarily due to warmer weather in 2004 as compared with 2003 in all of the Company's service territories.

Weather in Missouri Gas Energy's service territories was 93% of a 30-year measure for the nine-month period ended March 31, 2004, compared with 100% in 2003. PG Energy's service territories experienced weather that was 102% of a 30-year measure for the nine-month period ended March 31, 2004, compared with 106% in 2003. Weather for the New England Gas Company service territories was 99% of a 30-year measure for the nine-month period ended March 31, 2004, compared with 104% in 2003.

Operating Margin. Operating margin (operating revenues less gas purchase and other energy costs and revenue-related taxes) decreased $1,660,000 for the three-month period ended March 31, 2004 compared with the same period in 2003. Operating margins and earnings are primarily dependent upon gas sales volumes and gas service rates. The level of gas sales volumes is sensitive to the variability of the weather as well as the timing of acquisitions and divestitures. Operating margin was also impacted by a $1,579,000 decrease in gas transportation revenues for the three-month period ended March 31, 2004 compared with the same period in 2003. Gas transportation revenues were impacted by certain customers utilizing alternative energy sources such as fuel oil, customer closure of certain facilities and various customers reducing production.

Operating margin decreased $8,944,000 for the nine-month period ended March 31, 2004 compared with the same period in 2003, principally as a result of the warmer weather, and a $3,924,000 reduction in gas transportation revenues, both previously discussed.

Operating Expenses. Operating expenses, which include operating, maintenance and general expenses, depreciation and amortization and taxes other than on income and revenues, were $75,226,000 for the three-month period ended March 31, 2004, an increase of $10,298,000, compared with $64,928,000 for the same period in 2003.

Operating expenses were impacted by $3,069,000 of increased bad debt expense resulting from higher customer receivables due to higher gas prices, $3,022,000 of increased pension and other post retirement benefits costs primarily due to the impact of stock market volatility on plan assets, $1,540,000 of increased medical costs, and increased employee payroll costs due to general wage increases and increased overtime due to system maintenance and Sarbanes-Oxley Section 404 documentation procedures.

Operating expenses were $205,598,000 for the nine-month period ended March 31, 2004, an increase of $22,589,000, as compared with $183,009,000 for the same period in 2003. Operating expenses were impacted by $6,828,000 of increased pension and other post retirement benefits costs, $5,372,000 of increased bad debt expense, $1,978,000 of increased medical costs, $989,000 of increased depreciation and amortization, primarily due to normal plant growth, and increased employee payroll costs, as previously discussed.

Due to the previously discussed colder than normal weather combined with a 33% increase in the average cost of gas in 2004, this could put some pressure on collections and increase the Company's exposure to bad debts during fiscal 2004 and thus may affect the operating results for this segment for the remainder of the fiscal year. As of March 31, 2004, the Company believes that its reserves for bad debt are adequate though based on historical trends and collections. The Company also anticipates increased costs related to pension and other post retirement benefits and insurance costs which were anticipated in the Company's fiscal year 2004 earnings guidance.

Transportation and Storage Segment -- The Transportation and Storage segment is primarily engaged in the interstate transportation and storage of natural gas in the Midwest and Southwest, and also provides LNG terminalling and regasification services. Its operations are conducted through Panhandle Energy, which the Company acquired on June 11, 2003.

Panhandle Energy operates a large natural gas pipeline network, which provides approximately 500 customers in the Midwest and Southwest with a comprehensive array of transportation services. Panhandle Energy's major customers include 25 utilities located primarily in the United States Midwest market area, which encompasses large portions of Illinois, Indiana, Michigan, Missouri, Ohio and Tennessee.

The results of operations from Panhandle Energy have been included in the Consolidated Statement of Operations since June 11, 2003. The following table provides summary financial information regarding the Transportation and Storage segment's results of operations for the three- and nine-month periods ended March 31, 2004.

	Three Months Ended March 31, 2004	Nine Months Ended March 31, 2004
	(thousands of dollars)	
Financial Results		
Transportation and storage revenues	$ 121,860	$ 331,851
LNG terminalling revenues	13,762	44,146
Other revenues	2,557	6,745
Total operating revenues	138,179	382,742
Operating expenses:		
Operating, maintenance, and general	49,725	157,520
Depreciation and amortization (1)	11,954	45,112
Taxes other than on income and revenues	7,526	20,615
Total operating expense	69,205	223,247
Net operating revenues	$ 68,974	$ 159,495

(1) Depreciation and amortization reflected herein for the three-month period ended March 31, 2004 is $3,193,000 less than that reported by Panhandle Energy in its separate SEC filing for the same period. The outside appraisals for the Panhandle Energy assets acquired and liabilities assumed were finalized after Southern Union had filed their second quarter Form 10-Q but prior to Panhandle Energy filing its December 31, 2003 Form 10-K. Panhandle Energy was able to reflect depreciation and amortization expense consistent with the final outside appraisals as of December 31, 2003, which Southern Union recognized during the three-month period ended March 31, 2004.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table sets forth gas throughput and related information for the Company's Distribution segment and Transportation and Storage segment for the three- and nine-month periods ended March 31, 2004 and 2003:

	Three Months Ended March 31,		Nine Months Ended March 31,	
Distribution Segment	2004	2003	2004	2003
Average number of customers:				
Residential	853,825	849,011	843,462	839,761
Commercial	105,455	103,888	101,874	100,019
Industrial and irrigation	437	446	440	447
Public authorities and other	385	379	386	377
Total average gas sales customers	960,102	953,724	946,162	940,604
Transportation customers	2,694	2,511	2,611	2,493
Total average gas sales and transportation customers	962,796	956,235	948,773	943,097
Gas sales in millions of cubic feet (MMcf)				
Residential	42,239	43,696	63,588	68,006
Commercial	17,238	17,521	26,503	27,751
Industrial and irrigation	748	778	1,974	1,334
Public authorities and other	162	172	273	308
Gas sales billed	60,387	62,167	92,338	97,399
Net change in unbilled gas sales	(3,665)	(3,072)	6,688	7,220
Total gas sales	56,722	59,095	99,026	104,619
Gas transported	19,790	20,855	47,897	52,363
Total gas sales and gas transported	76,512	79,950	146,923	156,982
Gas sales revenues (thousands of dollars):				
Residential	$ 449,506	$ 384,227	$ 710,965	$ 629,791
Commercial	175,513	145,174	274,413	232,549
Industrial and irrigation	7,510	8,029	17,467	17,344
Public authorities and other	1,509	1,703	2,661	2,625
Gas revenues billed	634,038	539,133	1,005,506	882,309
Net change in unbilled gas sales revenues	(17,401)	(20,163)	86,222	59,525
Total gas sales revenues	616,637	518,970	1,091,728	941,834
Gas transportation revenues	12,111	13,690	27,346	31,270
Total gas sales and gas transportation revenues	$ 628,748	$ 532,660	$ 1,119,074	$ 973,104
Gas sales revenue per thousand cubic feet billed:				
Residential	$ 10.64	$ 8.79	$ 11.18	$ 9.26
Commercial	10.18	8.29	10.35	8.38
Industrial and irrigation	10.04	10.32	8.85	13.00
Public authorities and other	9.31	9.90	9.75	8.52
Weather:				
Degree days:				
Missouri Gas Energy service territories	2,595	2,723	4,422	4,732
PG Energy service territories	3,293	3,360	5,561	5,785
New England Gas Company service territories	3,062	3,131	4,939	5,193
Percent of 30-year measure:				
Missouri Gas Energy service territories	96%	100%	93%	100%
PG Energy service territories	106%	108%	102%	106%
New England Gas Company service territories	105%	108%	99%	104%
Transportation and Storage Segment				
Gas transported in billions of British thermal units (Bbtu)	351,791	–	1,018,307	–
Gas transportation revenues (thousands of dollars)	$ 111,106	$ –	$ 300,957	$ –

The above information does not include the Company's Texas operations, which were sold effective January 1, 2003 and are reported as discontinued operations in the Consolidated Statement of Operations for the respective periods. The 30-year measure of weather is used above for consistent external reporting purposes. Measures of normal weather used by the Company's regulatory authorities to set rates vary by jurisdiction. Periods used to measure normal weather for regulatory purposes range from 10 years to 30 years.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FINANCIAL CONDITION

The Company's operations are seasonal in nature with a significant percentage of the annual revenues and earnings occurring in the traditional heating-load months. In the Distribution segment, this seasonality results in a high level of cash flow needs immediately preceding the peak winter heating season months, due to the required payments to natural gas suppliers in advance of the receipt of cash payments from customers. The Company has historically used internally generated funds and its credit facilities to provide funding for its seasonal working capital, continuing construction and maintenance programs and operational requirements.

On April 3, 2003, the Company entered into a short-term credit facility in the amount of $140,000,000 (the *Short Term Facility*), that matured April 1, 2004. The Short-Term Facility was increased to $150,000,000 as of September 25, 2003. Also on April 3, 2003, the Company amended the terms and conditions of its $225,000,000 long-term credit facility (the *Long-Term Facility*), which expires on May 29, 2004. The Company has additional availability under uncommitted line of credit facilities (*Uncommitted Facilities*) with various banks. Borrowings under the facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. The Short-Term Facility and the Long-Term Facility (together, the *Facilities*) are subject to a commitment fee based on the rating of the Senior Notes. The Company is in the process of entering a new five-year credit facility that will replace the Short Term Facility and the Long Term Facility. The Company expects that the new facility will contain substantially similar terms and conditions as the existing facilities. As of March 31, 2004, the commitment fees were an annualized 0.15% on the Facilities. The interest rate on borrowings on the Facilities is calculated based upon a formula using the LIBOR or prime interest rates. There were no borrowings outstanding under the Facilities at May 7, 2004.

In July 2003, Panhandle Energy announced a tender offer for any and all of the $747,370,000 outstanding principal amount of five of its series of senior notes outstanding at that point in time (the *Panhandle Tender Offer*) and also called for redemption all of the outstanding $134,500,000 principal amount of its two series of debentures that were outstanding (the *Panhandle Calls*). Panhandle Energy repurchased approximately $378,257,000 of the principal amount of its outstanding debt through the Panhandle Tender Offer for total consideration of approximately $396,445,000 plus accrued interest through the purchase date. Panhandle Energy also redeemed approximately $134,500,000 of debentures through the Panhandle Calls for total consideration of $139,411,000, plus accrued interest through the redemption dates. As a result of the Panhandle Tender Offer, the Company has recorded a pre-tax gain on the extinguishment of debt of $6,123,000 in August 2003. In August 2003, Panhandle Energy issued $300,000,000 of its 4.80% Senior Notes due 2008 and $250,000,000 of its 6.05% Senior Notes due 2013 principally to refinance the repurchased notes and redeemed debentures. Also in August and September 2003, Panhandle Energy repurchased $3,150,000 principal amount of its senior notes on the open market through two transactions for total consideration of $3,398,000, plus accrued interest through the repurchase date.

On October 1, 2003, the Company called its Subordinated Notes for redemption, and its Subordinated Notes and related Preferred Securities were redeemed on October 31, 2003 (see *Preferred Securities* in Notes to Consolidated Financial Statements). The Company financed the redemption with borrowings under its revolving credit facilities, which were paid down with the net proceeds of a $230,000,000 offering of preferred stock by the Company on October 8, 2003, as further described below.

On October 8, 2003, the Company issued 920,000 shares of its 7.55% Noncumulative Preferred Stock, Series A (Liquidation Preference $250 Per Share) to the public through the issuance of 9,200,000 Depositary Shares, each representing a one-tenth interest in a 7.55% Noncumulative Preferred Stock, Series A share at the public offering price of $25.00 per share, or $230,000,000 in the aggregate. After the payment of issuance costs, including underwriting discounts and commissions, the Company realized net proceeds of $223,587,000. The total net proceeds were used to repay debt under the Company's revolving credit facilities. The issuance of this Preferred Stock and use of proceeds is continued evidence of the Company's commitment to the rating agencies to strengthen the Company's balance sheet and solidify its current investment grade status.

On March 12, 2004, Panhandle Energy issued $200,000,000 of its 2.75% Senior Notes due 2007, the proceeds of which were used to fund the redemption of the remaining $146,080,000 principal amount of its 6.125% Senior Notes

due 2004 that matured on March 15, 2004 and to provide working capital to the Company, pending the repayment of the $52,455,000 principal amount of Panhandle Energy's 7.875% Senior Notes due 2004 that mature on August 15, 2004.

The principal sources of funds during the three-month period ended March 31, 2004 were $239,270,000 in cash flow from operations and $200,000,000 from the issuance of long-term debt. This provided funds of $162,691,000 for the repayment of debt, $176,500,000 for the repayment of borrowings under the revolving credit facilities and $43,331,000 for on-going property, plant and equipment additions.

The principal sources of funds during the nine-month period ended March 31, 2004 were $750,000,000 from the issuance of long-term debt, $230,000,000 from the issuance of preferred stock and $230,490,000 in cash flow from operations. This provided funds of $879,844,000 for the repayment of debt and capital lease obligations, $176,000,000 for the repayment of borrowings under the revolving credit facilities and $154,422,000 for on-going property, plant and equipment additions.

The effective interest rate under the Company's current debt structure is 5.29% (including interest and the amortization of debt issuance costs and redemption premiums on refinanced debt).

The Company retains its borrowing availability under the Long Term Facility and is in negotiations with its bank groups to enter into a replacement Long Term Facility, as discussed above. The Company expects to be able to raise sufficient new commitments from banks to fully replace the existing commitments, although the ability to replace such commitments will be subject to future economic conditions and financial, business and other factors beyond the Company's control. Borrowings under these credit facilities will continue to be used, as needed, to provide funding for the seasonal working capital needs of the Company. Internally-generated funds from operations will be used principally for the Company's ongoing construction and maintenance programs, operational needs and the periodic reduction of outstanding debt.

The Company has an effective shelf registration statement on file with the Securities and Exchange Commission for a total principal amount of $800,000,000 in securities of which $42,170,000 in securities is available for issuance as of May 7, 2004, which may be issued by the Company in the form of debt securities, common stock, preferred stock, guarantees, warrants to purchase common stock, preferred stock and debt securities, stock purchase contracts, stock purchase units and depositary shares in the event that the Company elects to offer fractional interests in preferred stock, and also trust preferred securities to be issued by Southern Union Financing II and Southern Union Financing III. Southern Union may sell such securities up to such amounts from time to time, at prices determined at the time of any such offering.

On March 19, 2004, the Company filed a shelf registration with the Securities and Exchange Commission for a total principal amount of $1,000,000,000 in securities, including securities previously registered and not issued pursuant to the effective registration statement noted above, which may be issued by the Company in the form of debt securities, common stock, preferred stock, guarantees, warrants to purchase common stock, preferred stock and debt securities, stock purchase contracts, stock purchase units and depositary shares in the event that the Company elects to offer fractional interests in preferred stock, and also trust preferred securities to be issued by Southern Union Financing II and Southern Union Financing III. Upon the Securities and Exchange Commission declaring this shelf effective, Southern Union may sell such securities up to such amounts from time to time, at prices determined at the time of any such offering.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There are no material changes in market risks faced by the Company from those reported in the Company's Annual Report on Form 10-K for the year ended June 30, 2003.

The information contained in Item 3 updates, and should be read in conjunction with, information set forth in Part II, Item 7 in the Company's Annual Report on Form 10-K for the year ended June 30, 2003, in addition to the interim consolidated financial statements, accompanying notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations presented in Items 1 and 2 of this Quarterly Report on Form 10-Q.

OTHER MATTERS

Customer Concentrations. In the Transportation and Storage segment, aggregate sales to Panhandle Energy's top 10 customers accounted for 71% of segment operating revenues and 18% of total consolidated operating revenues for the nine-month period ended March 31, 2004. This included sales to ProLiance Energy, LLC, a nonaffiliated local distribution company and gas marketer, which accounted for 17% of segment operating revenues, sales to BG LNG Services, a nonaffiliated gas marketer, which accounted for 15% and sales to CMS Energy Corporation, Panhandle Energy's former parent, which accounted for 11% of segment operating revenues. No other customer accounted for 10% or more of the Transportation and Storage segment operating revenues, and no customer accounted for 10% or more of total consolidated operating revenues, for the nine-month period ended March 31, 2004.

Cash Management. On October 25, 2003, FERC issued the final rule in Order No. 634-A on the regulation of cash management practices. Order No. 634-A requires all FERC-regulated entities that participate in cash management programs (i) to establish and file with FERC for public review written cash management procedures including specification of duties and responsibilities of cash management program participants and administrators, specification of the methods for calculating interest and allocation of interest income and expenses, and specification of any restrictions on deposits or borrowings by participants, and (ii) to document monthly cash management activity. In compliance with FERC Order No. 634-A, Panhandle Energy filed its cash management plan with FERC on December 11, 2003.

Pipeline Safety Notice of Proposed Rulemaking. On December 12, 2003, the U.S. Department of Transportation issued a final rule requiring pipeline operators to develop integrity management programs to comprehensively evaluate their pipelines, and take measures to protect pipeline segments located in "high consequence areas." The final rule takes effect on January 14, 2004 and incorporates requirements of the Pipeline Safety Improvement Act, enacted in December 2002. Although the Company cannot predict the actual costs of compliance with this rule, it does not expect the order to have a material incremental effect on the Company's Transportation and Storage segment operations because such required activities were already being undertaken.

Investment Securities. The Company reviews its portfolio of investment securities on a quarterly basis to determine whether a decline in value is other than temporary. Factors that are considered in assessing whether a decline in value is other than temporary include, but are not limited to: earnings trends and asset quality; near term prospects and financial condition of the issuer, including the availability and terms of any additional financing requirements; financial condition and prospects of the issuer's region and industry, customers and markets and Southern Union's intent and ability to retain the investment. If Southern Union determines that the decline in value of an investment security is other than temporary, the Company will record a charge on its Consolidated Statement of Operations to reduce the carrying value of the security to its estimated fair value.

Capital Expenditures. Capital expenditures, which consist primarily of expenditures to expand and maintain the Company's gas distribution and pipeline systems, were $154,422,000 and $43,331,000 for the nine- and three- month periods ended March 31, 2004, respectively. Capital expenditures for the year ended June 30, 2004, excluding capital expenditures for the Trunkline LNG expansion, modification and pipeline loop, are presently anticipated to be approximately $150,000,000.

On February 2, 2004, the Company announced a Phase II modification at Trunkline LNG to expand the capacity of the facility to a sustained send out of 1.8 Bcf per day and a peak send out of 2.1 Bcf per day. In addition, Trunkline will construct a 23-mile loop pipeline from the Trunkline LNG facility that will increase the takeaway capacity from 1.3 Bcf per day to 2.1 Bcf per day. The total cost of these projects is expected to be approximately $115,000,000, excluding capitalized interest. It is anticipated that the 23-mile loop pipeline will be in service by mid 2005 and that the Phase II modification will be completed by mid 2006. Including Trunkline LNG's Phase I, Phase II and the 23-mile loop pipeline construction, total capital expenditures are expected to approximately $250,000,000 of which approximately $44,000,000 has been spent to date in fiscal 2004, and are expected to generate approximately $80,000,000 of annualized revenue, once all projects are in service.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Management's Discussion and Analysis of Results of Operations and Financial Condition and other sections of this Quarterly Report on Form 10-Q contain forward-looking statements that are based on current expectations, estimates and projections about the industry in which the Company operates, management's beliefs and assumptions made by management. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. Similarly, statements that describe our objectives, plans or goals are or may be forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict and many of which are outside the Company's control. Therefore, actual results, performance and achievements may differ materially from what is expressed or forecasted in such forward-looking statements. The Company undertakes no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. Readers are cautioned not to put undue reliance on such forward-looking statements. Stockholders may review the Company's reports filed in the future with the Securities and Exchange Commission for more current descriptions of developments that could cause actual results to differ materially from such forward-looking statements.

Factors that could cause actual results to differ materially from those expressed in our forward-looking statements include, but are not limited to, the following: cost of gas; gas sales volumes; gas throughput volumes and available sources of natural gas; discounting of transportation rates due to competition; customer growth; abnormal weather conditions in the Company's service territories; the achievement of operating efficiencies and the purchases and implementation of new technologies for attaining such efficiencies; impact of relations with labor unions of bargaining-unit employees; the receipt of timely and adequate rate relief and the impact of future rate cases or regulatory rulings; the outcome of pending and future litigation; the speed and degree to which competition is introduced to our gas distribution business; new legislation and government regulations and proceedings affecting or involving the Company; unanticipated environmental liabilities; the Company's ability to comply with or to challenge successfully existing or new environmental regulations; changes in business strategy and the success of new business ventures; the risk that the businesses acquired and any other businesses or investments that Southern Union has acquired or may acquire may not be successfully integrated with the businesses of Southern Union; exposure to customer concentration with a significant portion of revenues realized from a relatively small number of customers and any credit risks associated with the financial position of those customers; factors affecting operations such as maintenance or repairs, environmental incidents or gas pipeline system constraints; our or any of our subsidiaries debt securities ratings; the economic climate and growth in our industry and service territories and competitive conditions of energy markets in general; inflationary trends; changes in gas or other energy market commodity prices and interest rates; the current market conditions causing more customer contracts to be of shorter duration, which may increase revenue volatility; the possibility of war or terrorist attacks; the nature and impact of any extraordinary transactions such as any acquisition or divestiture of a business unit or any assets. These are representative of the factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions, and general economic conditions, including interest rate fluctuations, federal, state and local laws and regulations affecting the retail gas industry or the energy industry generally, and other factors.

CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer (*CEO*) and Chief Financial Officer (*CFO*), and with the participation of personnel from our Legal, Internal Audit, Risk Management and Financial Reporting Departments, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of March 31, 2004 and have communicated that determination to the Audit Committee of our Board of Directors.

Changes in Internal Controls

There have been no significant changes in our internal controls or other factors that could significantly affect internal controls subsequent to their evaluation for the quarterly period ended March 31, 2004.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

EXHIBITS AND REPORTS ON FORM 8-K

Exhibits:

The following exhibits are filed as part of this Quarterly Report on Form 10-Q:

31.1 Certificate by Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certificate by Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certificate by Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) promulgated under the Securities Exchange Act of 1934 and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

32.2 Certificate by Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) promulgated under the Securities Exchange Act of 1934 and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

Reports on Form 8-K:

The Company filed the following Current Reports on Form 8-K during the quarter ended March 31, 2004:

Date Filed	Description of Filing
2/2/2004	Announcement of operating performance for the quarter ended December 31, 2003 and 2002 and filing, under Item 12, summary statements of income of Southern Union Company for the quarter ended December 31, 2003 and 2002 (unaudited) and notes thereto; also filing under Item 5, the press release issued by Southern Union Company announcing the agreement between its subsidiary, Trunkline LNG Company, and BG LNG Services, LLC, (a subsidiary of BG Group of the United Kingdom), for the proposed Phase II modification of Trunkline LNG's Lake Charles, LA, liquefied natural gas terminal, and an agreement between its subsidiary, Trunkline Gas Company, and BG LNG Services, LLC for the construction of a 23-mile pipeline from the LNG terminal to the mainline of Trunkline Gas Company.
3/12/2004	Furnishing under Item 9, the press release issued by Southern Union Company announcing the closing of a private placement offering of $200,000,000 of 2.75% Senior Notes due 2007, Series A, by its wholly-owned subsidiary, Panhandle Eastern Pipe Line Company, LLC.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SOUTHERN UNION COMPANY
(Registrant)

Date May 14, 2004

By DAVID J. KVAPIL
David J. Kvapil
Executive Vice President and Chief Financial Officer

Exhibit 31.1

CERTIFICATIONS

I, George L. Lindemann, certify that:

(1) I have reviewed this quarterly report on Form 10-Q of Southern Union Company;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2004

GEORGE L. LINDEMANN
George L. Lindemann
Chairman of the Board and
Chief Executive Officer
(principal executive officer)

Exhibit 31.2

CERTIFICATIONS

I, David J. Kvapil, certify that:

(1) I have reviewed this quarterly report on Form 10-Q of Southern Union Company;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2004

DAVID J. KVAPIL
David J. Kvapil
Executive Vice President and
Chief Financial Officer
(principal financial officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO,
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Form 10-Q of Southern Union Company (the "Company") for the quarter ended March 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, George L. Lindemann, Chairman of the Board and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

GEORGE L. LINDEMANN
George L. Lindemann
Chairman of the Board and
Chief Executive Officer
May 14, 2004

This certification is furnished pursuant to Item 601 of Regulation S-K and shall not be deemed filed by the Company for purposes of §18 of the Securities Exchange Act of 1934, as amended, or otherwise be subject to the liability of that section. Such certification shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent the Company specifically incorporates it by reference.

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Form 10-Q of Southern Union Company (the "Company") for the quarter ended March 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David J. Kvapil, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

DAVID J. KVAPIL
David J. Kvapil
Executive Vice President and
Chief Financial Officer
May 14, 2004

This certification is furnished pursuant to Item 601 of Regulation S-K and shall not be deemed filed by the Company for purposes of §18 of the Securities Exchange Act of 1934, as amended, or otherwise be subject to the liability of that section. Such certification shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent the Company specifically incorporates it by reference.